RETAILING SERIES

RETAIL MERCHANDISING
PLANNING AND CONTROL

BY

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FOREWORD

Research is the fundamental principle of the new retailing. Retailing facts must be organized on a sound and dependable basis. This is the greatest necessity at present, in order that retailing may approach a scientific basis, and that store executives may approach their problems with a certainty of results.

What is sadly needed in retailing is the building up of a store of tested and classified retailing knowledge. The extent of this store of knowledge will decide the rapidity of the reduction of retailing practice to a professional basis. The fund of classified retailing knowledge, ever increasing with analytical study, will assure more scientific distribution in the future.

During the past five years, members of the faculty of the School of Retailing have been studying retailing practices. The chief aim is to ascertain retailing principles and the difficulties that arise in the application of these principles. A close coöperation between the School of Retailing and store executives was absolutely essential and this has been given heartily from the first.

The Retailing Series consists of separate independent studies of various phases of retailing. The aim is to include the chief divisions of merchandising, publicity, service, and finance and control. In working out each study, there is a careful and detailed study of practice and a careful checking by experts in the work.

Retail Merchandising, Planning and Control has a definite threefold purpose. First, to present the principles underlying retail merchandising, planning, and control; second, to present actual problems embodying the principles; and third, to meet pedagogical requirements by combining text and case methods of presenting the subject. The content of this book was first presented in the classroom in the fall term of 1923-1924. Since that time the course has been repeated four times. After each presentation the content was carefully checked

with buyers, merchandise men, and controllers. Special care has been taken to link problems and principles. The problems have been collected from actual practice, and the principles underlying the solution of each problem are found in the text.

The merchants of New York and Brooklyn, and of Newark, New Jersey, comprising the Advisory Council of the New York University School of Retailing, through their foresight and generosity, made the first School of Retailing in the history of commerce possible. The merchants and their executives have given the fullest and the heartiest coöperation in the research work conducted by the members of the faculty of the School of Retailing. Speaking frankly, without their interest, their coöperation, and their loyalty to the cause of retailing, the Retailing Series would have been impossible.

NORRIS A. BRISCO, *Editor*

PREFACE

Although the function of merchandising is essentially the same in all retail institutions, the methods are almost as numerous as the stores themselves. New ideas are recommended, introduced, and discarded on every hand. The high cost of merchandising has attracted the attention, not only of producers and consumers, but of governmental agencies, educational institutions, and retail trade associations. Merchandising has become extremely aggressive, with the result that the margin of net profit of the retail merchant is narrow. It seems obvious that the only real approach to a more economic plan of distribution is to be found in a thorough understanding and adherence to sound principles of merchandising.

This book is written with the idea of helping the reader recognize and understand sound principles underlying the successful operation of a retail store. It is meant to appeal to those interested in the problems of merchandising, whether they be in the classroom or in the store. It is felt that successful retail merchandising practices can be analyzed and the underlying principles presented in such a way as to make it more nearly approach a science. In presenting the material of this book no attempts have been made arbitrarily to designate good or bad practices, but rather to show how different practices may be tested and logical conclusions drawn. The idea is to show how the problems may be solved rather than to present their solution. With this end in view each chapter is supplemented with specific problems taken from actual practice, which call forth a clear understanding of the principles discussed in the text, thus combining text and case method of presenting the subject.

Because of the large number of people to whom the author is indebted for advice and information, it is not possible to make specific acknowledgments except to retail executives in general. For statistical facts regarding the expenses of retail store operations the Harvard Bureau of Business Research has been drawn upon heavily and for recommended standards

of practice the author is especially indebted to the Controllers' Congress of the National Retail Dry Goods Association. It was in large part through the enthusiasm and suggestions of Dr. Norris A. Brisco that this book was made possible and the author has a deep feeling of appreciation for the advice and aid he has given.

JAMES L. FRI

CONTENTS

ILLUSTRATIONS

TABLES

RETAIL MERCHANDISING

PLANNING AND CONTROL

RETAIL MERCHANDISING
PLANNING AND CONTROL

CHAPTER I

THE FIELD OF RETAILING

One of the essential characteristics of the competitive commercial system which prevails in the United States is the active solicitation of patronage by those who have commodities to sell. This competition begins with the producer and extends throughout the whole channel of distribution. Under the present industrial system, production is directly dependent upon the sale of commodities to the ultimate consumer. A shoe manufacturer, for example, is warranted in continuing to manufacture shoes only when he has orders, or has a reasonable assurance that orders will be placed by his customers. Likewise, the retailer purchases from the wholesaler and manufacturer only when he in turn anticipates a demand from his customers. The initiative in carrying on this continuous process of exchange lies both with the producer and the merchant, who not only offer their commodities for sale, but aggressively seek to induce consumers to purchase them. "Retail merchandising" is the term applied to the activities of the merchant in bringing about the most advantageous proportion between sales, stocks, and profits. It includes not only the buying of goods, but the active solicitation of the patronage of customers through aggressive promotion of sales.

The retailer performs the final function in distribution by making merchandise available to consumers at the time, and the place, and in the quantities required by them. In order properly to perform this function, it is necessary for him to select and carry a reserve supply of commodities to meet the

anticipated requirements of the individual customers, and thus to act as a purchasing agent for the community which he serves. For this service he is paid a margin of profit for which he is justified, from an economic point of view, because he produces time and place utilities and undergoes a risk. In so far as the retailer acts as a purchasing agent for the consumer, he assumes the responsibility of providing commodities and services that are economical and convenient to his community. His ability to give service in competition with other retailers is determined by the following fundamental factors:

1. Value received for money spent.
2. Opportunity for selection, because of a wide range of stock and assortment of merchandise.
3. Accessibility of the store or other source of supply.
4. The speed and facility with which purchases may be made.
5. Convenience in purchasing, such as the assembling of merchandise under one roof, delivery of goods, credit, and exchanges.
6. Character of the merchandise in relation to fashion or style.

Because of the influence of these factors there have developed different types of retail stores performing the final function of distribution, each maintaining itself in the face of competition, because of a particular service which it renders. Although the major functions of all stores are essentially the same, there is a wide variation in the manner in which these functions are performed. A brief survey of the different retail agencies will serve to indicate the general characteristics of their merchandising activities.

Unit Stores.

The unit store is a retail store that is owned and managed as an independent unit for the sale of merchandise through personal salesmanship. It may handle only one class of goods, as groceries, or a wide variety of general merchandise without an elaborate departmental organization. Its particular service or function is to make a wide variety of merchandise

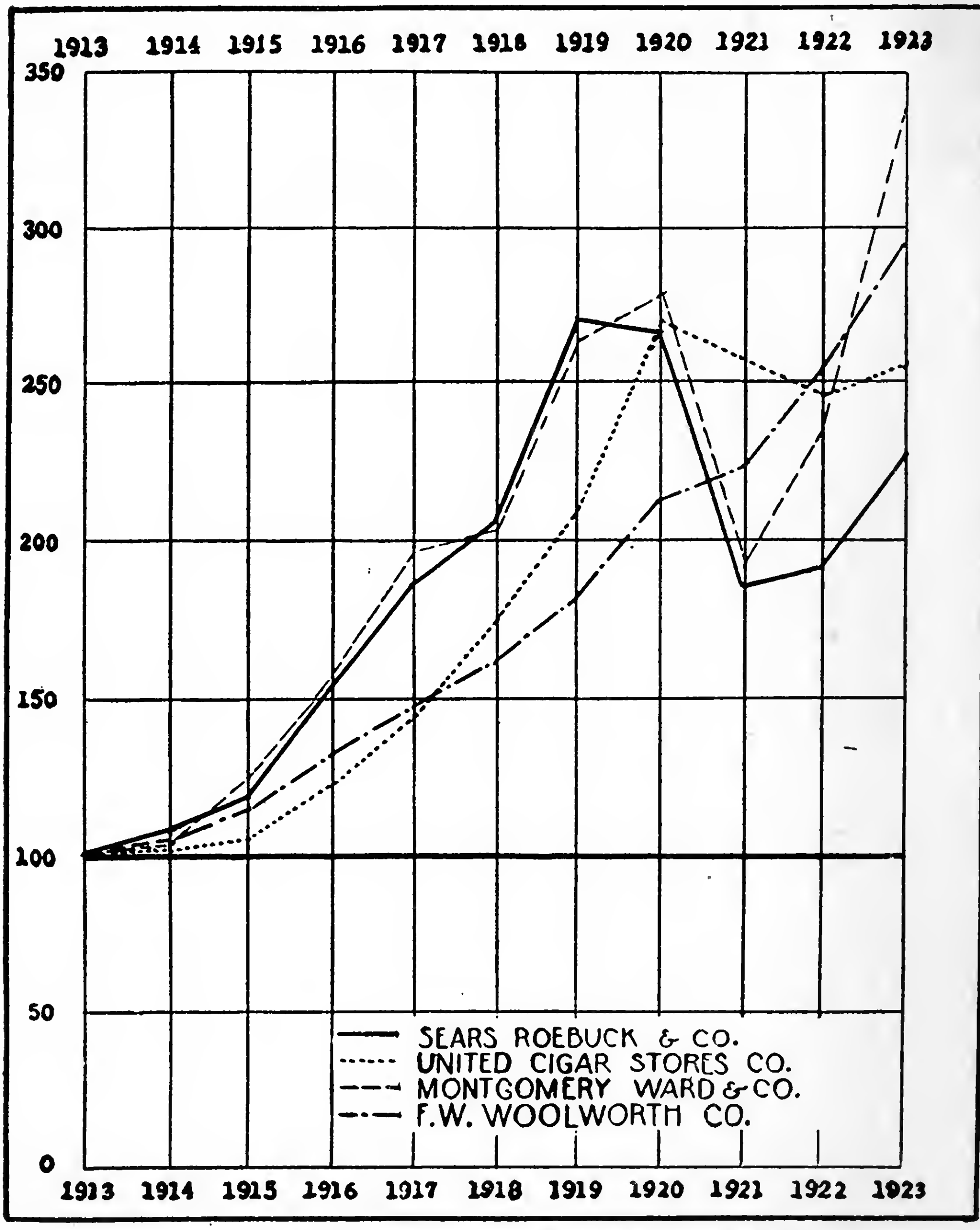
accessible to as large a number of people as possible. Although no accurate information has been compiled regarding the number of unit stores in the United States, it is reasonably certain that there are at least 1,000,000. This type of store does approximately 70 per cent of the total retail business of the country, the major portion of which is in convenience goods. Accessibility is the factor that has developed the unit store, and it is the factor that will maintain it in the face of competition.

The unit store lacks the specialization and efficient management found in chain and department stores. Only a small percentage of unit or independent stores has an adequate system of cost accounting, and it is not uncommon for the proprietor to be losing money without knowing it. Many retailers operating stores of this type fail to include in their operating expenses salaries for themselves, rent for the store buildings which they own, and interest on the money which they have invested in the business. With the continual influx of men from other occupations into the retail trade as proprietors of unit stores, this business is largely an unskilled profession. Its chief advantage lies in the personal and intimate contact which the retailer is enabled to maintain with his clientele. Such contact makes possible an intelligent service applied to the particular needs of individual customers. For example, in a grocery store where some customers desire credit and delivery of merchandise, a unit store which is under the personal supervision of its proprietor can provide these services with a minimum of administrative burden and at the same time attract patronage. With these advantages over other types of stores, the future existence of the unit store depends on whether it adopts more scientific methods in its operation, particularly in accounting and in buying. Improvements are being made continually for effecting economies in the cost of doing business, but a long process of education is still necessary if the unit store is to compete favorably with chain and department stores, especially in the urban districts.

Chain Stores.

A chain-store system is a group of stores handling similar lines of merchandise with single ownership and centralized

management, but with decentralized location. The chief advantage of such a system lies in the possibility of saving through large-scale buying and through standardization of



"Survey of Current Business," United States Department of Commerce.

Fig. 1—Sales in Different Types of Retail Stores (1913 = 100).

equipment, of methods of operation, and of management. Chain stores, as a rule, have been successful in marketing all products that are sold over the counter. It is in the sale of convenience goods, however, that the chain-store system has

shown the most rapid growth, particularly since 1915. The grocery chains were the first in the field. Although a large number of these chains are merely local enterprises, some companies in the convenience goods trade have extended their activities over a wide area.

Growth of chain stores.—The first of the present chain-store systems was the Great Atlantic and Pacific Tea Company, which was established in 1858. In 1910 this company, which now operates in many parts of the United States, had approximately 350 branches. In 1914 it was operating 650 stores with aggregate sales of $31,299,124; and in the year ending February 28, 1923, the sales of the company were $246,940,873, with 7,500 stores in operation. The Jones Brothers Tea Company came into existence in 1872 and the Woolworth Five and Ten Cent Stores in 1879. The growth in sales volume of the F. W. Woolworth Company since 1913 is shown in Figure 1. Since 1900 the chain-store idea has spread to a great variety of lines, including tobacco products, confectionery, drugs, haberdashery, clothing, dry goods, and even department stores. According to the best estimates there are now considerably over 2,000 chain-store systems in this country with a total of over 60,000 retail outlets.

The chain stores do a total annual business of $2,000,-000,000, equal to a little over 8 per cent of the retail trade of the United States. Although these stores have increased rapidly, the number in operation is only 3.7 per cent of the total number of retail units in the country.[1] The figures given on page 6 indicate the growth in sales volume and in the number of branches of some of the leading chain-store systems during the last four years. The full scope of chain-store growth is by no means completely set forth in this partial list, although the totals furnish an idea of what some of the leaders are accomplishing.

Chain stores specialize usually in the goods they handle and eliminate slow-selling lines, goods that offer smaller profit-making prospects, and merchandise in which losses are likely to occur. This specialization is significant, in that it permits scientific and economic buying, and standardized methods in receiving, in store accounting, and in selling procedure. As a rule chain stores choose convenient locations to bring the

[1] New York Trust Company: "The Index," October, 1924.

TABLE I

CHAIN-STORE SALES *
(000 omitted)

	1923	1922	1921	1920
F. W. Woolworth Co.	$193,447	$167,319	$147,655	$140,919
S. S. Kresge Co.	81,843	65,101	55,850	51,245
United Cigar Stores Co.	74,209	72,499	76,522	79,662
J. C. Penney Co.	62,189	49,000	47,000	43,000
Schulte Realty Stores Corp.	26,000	23,000	20,000	16,000
McCrory Stores Corp.	21,368	17,123	14,406	14,199
G. R. Kinney Co.	14,107	12,330	12,249	15,065
Melville Shoe.	6,200	4,712	4,505	4,768

NUMBER OF STORES

	1923	1922	1921	1920
F. W. Woolworth Co.	1260	1182	1137	1111
S. S. Kresge Co.	233	212	199	189
United Cigar Stores Co.	2440	2487	1990	1920
J. C. Penney Co.	475	371	312	297
Schulte Realty Stores Corp.	255	239	222	196
McCrory Stores Corp.	167	161	159	156
G. R. Kinney Co.	188	120	102	75
Melville Shoe	82	31	19	19

* *New York Evening Post,* May 24, 1924.

goods as near to the customer as possible, and in this way directly compete with unit stores. The chain-store system, however, is primarily an urban institution. Up to the present time it has not been found generally applicable to the requirements of small towns and villages. Almost all chain organizations have suitable buildings of pleasing appearance, easy entrance, appropriate and standardized fixtures and display, adequate lighting, and efficient use of selling aids. The sales people, as a rule, have a more thorough knowledge of the goods, because of their specialized nature.

On the other hand, a chain system has disadvantages which may prevent it from completely eliminating the independent or unit store. In the first place, its standardized method of doing business does not permit as complete an adjustment to local conditions as the unit store. The personal contact which the neighborhood store owner has with his clientele will always retard the chain-store development. The J. C. Penney Company, which operates a chain of small department stores, has partly solved the problem of absentee ownership by absorbing

local stores and owners in the expansion of its system. In 1923 this system was approximately twenty years old and had five hundred stores with an annual volume of $62,188,979, as compared with $8,415,877 in 1916.

The advantage accruing to large-scale buying is partly discounted by the added cost of warehousing. When the chain organization buys in large quantities and redistributes the goods to its stores, it performs part of the functions of the jobber or wholesaler and must necessarily bear some of the costs entailed in performing this function, such as expenditures for warehousing, stockkeeping, transportation, and general overhead. Furthermore, the branches of chain systems lose both the opportunity of taking advantage of favorable local price in purchasing, and the facility of adjusting their prices to local conditions as affected by competition. It is in the lack of coördination between the buying and the selling of merchandise that the greatest weakness of the chain system lies.

Future of chain stores.—The future of any store depends directly upon its ability to perform the function of retailing in competition with other stores. Chain systems are certain to continue to increase and to grow, so long as the average managing ability of independent store managers is lower than the organized ability of chain organizations, and so long as the buying power of chains gives them advantage over independent stores. Chain-store systems came into existence and will continue to exist and grow, because they are performing a definite kind of service not adequately covered by any other type of retail institution. To a large degree they have attained success by offering a more limited service than is given by the average independent retailer, and by specialization in merchandise, which has enabled them somewhat to undersell independent stores. They have developed certain phases of retail distribution to a high degree of efficiency and have thereby set examples for the managers of all types of stores. There is, however, no particular advantage in the chain-store system which cannot be enjoyed by the independent store. The importance of more complete and more intelligent retail accounting, methods of arrangement and display of merchandise, and the advantages of proper location, as taught by the chain stores, are all possible for the independent store. As competition increases, these lessons are being learned, and the

unit store is rapidly profiting by the more efficient methods of chain systems.

Furthermore, the success of chain-store companies has reached a point where it has attracted the attention of speculative financial promoters who have launched new chain-store enterprises on a large scale. Generally, these promoters are not familiar with the merchandising problems involved in chain organizations and management, and the requirements of merchandise control. In most instances the companies that have been successful were built up by the founders, either by establishing new stores or by buying going stores. Experience in general has indicated that the former method is the better policy. Although the proprietor of an established store may have goodwill which is valuable, he often demands a higher compensation for it than the capitalization of a chain will permit. Furthermore, his training is not in line with the requirements of chain-store management. Another disadvantage in purchasing an established business is that a large proportion of the stock cannot be used in the merchandise plan of a chain system.

The advantages of large-scale buying are passing rapidly from the chain-store systems, because of the activities of coöperative buying groups or associations of independent retailers. Coöperative buying has been slow of growth because the competition of the chains has not been general enough or keen enough to cause dealers to unite in self-defense; and because of the difficulty of organizing independent stores and educating dealers in the practice of coöperative work. In spite of these obstacles, however, there is little doubt that, as the pressure of competition increases, the independent or unit stores will assimilate and develop most of the advantageous practices of the chain-store systems and will maintain themselves as agents of retail distribution.

The Department Store.

According to the customary usage of the term, the department store is a retail institution organized into a departmental system with consolidated ownership and management of many lines of merchandise under one roof. The history of the development of the department store has not been definitely

failures of department stores during the past few years have been due largely to a mistaken theory that a large volume of business necessarily means economy of operation.

Mail-order Companies.

The mail-order company sells at retail from catalogues and not over the counter. These houses began to appear about the same time as department stores. They came into existence to supply the wants of people spread over great areas which ordinary methods of distribution could not adequately reach. The orders are received by mail at a central warehouse whence the goods are shipped direct to consumers. The mail-order house has used modern advertising methods and has greatly benefited from the development of easy and safe means of merchandise transportation and the improvement of the mail service and rural free delivery. The catalogue of a mail-order house gives an opportunity for shopping somewhat akin to a visit to the department store. The total volume of business of mail-order houses is approximately 4 per cent of the total retail business of the country. Over 1,200 mail-order houses in the United States are doing a business of more than $100,000.

Advantages.—Mail-order houses have the advantage of a large purchasing power, organized on scientific methods of buying and selling, low rentals, and a widely scattered clientele, so that local fluctuations in industrial conditions do not materially affect their business. On the other hand, they have high advertising and delivery expenses and they lack the facilities for personal shopping and over-the-counter contact which stimulate increased purchases. Mail-order houses are at a great disadvantage in a rising or falling market, because of the necessity of publishing the prices of the goods before they are sold. This prevents building up a surplus on a rising market to cover losses on a falling market. The necessity of buying merchandise in advance of the publication of the catalogue results in large inventories. They secure an especial advantage on a rising market as in 1919 and a part of 1920, because of the interval between the purchase of an article and its sale. A catalogue has ordinarily a life of about six months and the bulk of the merchandise for this six months' season

must be purchased approximately three months before the catalogue for that season goes to press. Thus, the losses which were sustained by mail-order houses in the latter part of 1920 and all of 1921 were severe, not only because of the decrease in sales, but because of the decrease in the retail value of their inventories. Whether or not a mail-order house is able to operate at a lower expense than unit stores is a question that has not yet been definitely settled. With the increase in traveling facilities and automobile traffic, the advantages of the mail-order house are rapidly decreasing, and there is little doubt that this type of retail distribution has reached the peak of its strength in competition with other retail agencies.

Specialty Stores.

A specialty store handles one class of goods only, as shoes, jewelry, or clothing. Metropolitan specialty stores are an outgrowth of unit stores. They have usually a departmental organization, but specialize in a particular line of merchandise. The departmentalized specialty stores have accounting problems similar to a department store, but their merchandising problems are by no means the same. There has been a general tendency toward the merchandising of specialty goods through chain-store systems. Such a system should be clearly differentiated from a chain of stores which merchandise convenience goods. By some, the term "specialty store" is applied to any institution selling only one line of merchandise. As used in this text, the term means a store handling a line of specialty goods which have some attraction for the consumer, other than price, which induces him to put forth special effort to visit the store in which they are sold. Specialty chain-stores, therefore, ordinarily operate not more than one store in a city, unless the city is very large. They have operating expenses quite similar to those of the other types of stores with which they compete. Their chief advantages are those that result from specialization in merchandise and in service. Their chief disadvantage is that they cater to a narrower clientele than the department store and, therefore, are more susceptible to the effect of industrial depression. Merchants attempting to operate a chain of specialty stores have difficulty in controlling the merchandising activities of the different

branches. The necessity of continually adjusting plans in accordance with local conditions requires that each store manager be permitted to exercise wide discretion, with the result that the central management is not able to maintain a uniform policy through the organization.

Direct Selling.

Direct selling by canvassers or house-to-house salesmen is the oldest type of retailing. No estimates can be made of the volume of merchandise which is sold direct to the consumer in this way, but it is reasonable to assume that it will never be a dangerous factor in competition with retail institutions. Direct-selling methods are not economical except in a few special lines which require demonstration or installation, as electrical fixtures and equipment. As a general rule, to deliver what has been ordered from the store is much more economical, in most lines of merchandise, than to attempt to deliver at several houses by direct-selling methods, with only a small percentage of actual sales. In most cases, the actual cost of selling direct is more than through a retail store. It is argued by the concerns selling direct that by bringing merchandise to the house the customer does not have to go out to shop. This has little weight, however, due to the fact that such a small number of lines are sold direct that the consumer must shop for other merchandise.

The house-to-house salesman must perform all of the functions which ordinarily are performed by the retail store, such as storing, actual selling, delivering, and collecting. In addition he must perform the function of shopping or traveling, which is ordinarily done by the individual customer who comes to the retail store. One of the common arguments is that direct salesmen have no advertising or rental expense. There is a failure on the part of those presenting this argument to consider that sales resistance must be broken down before a sale can be made. Either the manufacturer must do this through extensive advertising or the salesman must acquaint the customer with the merits of his goods through direct salesmanship. The function of advertising cannot be eliminated; it is merely a question of which method is most economical—the printed page or direct selling.

Expenses.—A close analysis of distribution will disclose the fact that there is a rental expense chargeable to all lines of merchandise. In selling direct, a large part of this expense is borne by the manufacturers who hold the goods in large quantities and parcel them out to individual salesmen. When all of the functions which the direct salesman performs are analyzed and compared with those performed by other agents of distribution, it is found that no steps have been eliminated.

In some sections of the country the activities of house-to-house canvassers have been so intensive as to cause the individual merchants to join together in combating their efforts. If direct selling from house-to-house is a more economical method of distribution for merchandise than through the retail store, nothing the retail merchant can do will prevent its general adoption. There is reason to believe, however, that house-to-house selling, if allowed to take its own course, will be self-destructive. There is a limit to the number of times that a housewife will allow a salesman to come in and show her his wares. Although there are a large number of legitimate concerns using direct-selling methods, the practice lends itself to abuse by unethical dealers and salesmen, to the detriment of all concerned.

In some localities the propaganda of the house-to-house salesman materially affects the confidence of the consumer regarding the profits of the retail store. Although this may work a temporary hardship on the retail merchant, the proof of the statement will lie in the comparative values of the merchandise as determined by use. If the merchandise of the house-to-house salesman actually has better value than that of the retail store, then the direct-selling method is justified from an economic point of view and should supplant the retail store. There is little reason to think that legal restrictions will ever be enacted to curtail this form of selling.

Coöperative Stores.

A coöperative store is one that is owned and managed by its customers. The typical coöperative store is organized on the Rochdale plan, whereby each member purchases one or more shares of stock at a small amount per share. This system has had a tremendous development in European coun-

tries, but in the United States the number is relatively small, there being approximately only 3,800 at the present time.

A coöperative store differs from those already discussed as to the method of operation and ownership rather than as to the type of store. It has many advantages over other types, in that it offers possibilities of cheaper administration, a smaller advertising expense, and a lower rental charge. It also maintains the interest of a permanent group of customers in its welfare. In actual operation, coöperative stores have the following disadvantages: (1) inability to get efficient managers from their own group of customers; (2) the unstable and transient habits of their customers; (3) the fact that the American public has become accustomed to many services and for the most part is unwilling to trade without them. It is not to be expected that the coöperative store will become a strong economic factor so long as the regular retail stores give satisfactory service. They come into existence only where there is a necessity, because of the inefficient operation of other types of stores.

Company or Commissary Stores.

The company or commissary store differs from the unit store only in its management. It is usually located in the section of the country where mining, lumbering, or large industrial companies are operating. There are, at present, about 8,000 of such stores, doing approximately 4 per cent of the total retail trade. Because of the nature of their business, however, they will gradually decrease with the development of towns and cities around industrial centers.

Future Development in Retailing.

The tendency in retailing is toward mass buying and large-scale distribution. There is no doubt that the advantages of large-scale buying will cause different retail stores to continue to develop along these lines. The importance of close contact with the primary market is increasing, especially in style merchandise. With the rapid development of transportation facilities, advertising mediums, style magazines, and other agencies, even the smaller communities are kept currently informed of the changes in the so-called style or market

centers. A buying office, or market representative, may keep the individual store informed of style or price tendencies but, to get the advantage of lower prices due to quantity purchases, it is necessary for individual stores to coördinate their buying through associations. The tendency will undoubtedly be toward central market representation for all stores handling any type of ready-to-wear in which there is a style element. This representative may be an independent buying association or a representative of a group of non-competing stores. In any case the principle of close contact with the central market and sufficient purchasing power must be adhered to if a store is to maintain itself in competition with other stores.

Department-store chains.—The principle of chain-store operation will undoubtedly develop, not only in the operation of unit stores, but in the consolidation of department stores, so that each department or line of merchandise may have an increased purchasing power. In a single department, the purchases are so widely distributed among different markets that, for a particular line of merchandise, advantage cannot be taken of quantity prices in competition with a combination of unit or chain stores. By combining several department stores the purchasing power of individual lines may be greatly increased and at the same time the advantage of department-store operation will not be lost. This consolidation will result in a higher specialization in different lines of merchandise and a freer exchange of successful merchandising experiences. Any consolidation of department stores must always be from the point of view of the complete protection of the selling units. Local initiative and management cannot be submerged. In other words, any organization for the combining of purchases must be an agency of service for the selling division.

The major advantages accruing to consolidation of department stores are:

1. Ability to buy supplies and equipment in large quantities at appreciable saving.
2. Increased purchasing power commands better prices.
3. Organization available for a more detailed research and development of resources.

4. Foreign markets may be more economically used and developed.

5. The development of consolidated purchasing power need not prevent any unit from taking advantage of local and individual conditions.

6. It offers the opportunity of developing a group of buying service units, research departments, and style analysts, each of which will greatly strengthen the individual departments and share the cost and risk of style sampling.

7. From the personnel point of view, it will add continuity of management and attract a high type of potential executive.

There is in any community a point of maximum expansion for a department store beyond which the law of diminishing returns sets in, as shown by a study of department-store expenses in a later chapter. Thus, the development of department stores themselves is limited by the growth of the community, but the horizontal development by consolidation is practically unlimited.

Department chains.—There has been some tendency toward a chain of departments in department stores. Distance from the primary resource markets complicates the merchandising problem of single units, especially of style lines, such as millinery and ladies' ready-to-wear. By leasing these departments in a number of stores, there has been set up a chain of departments operating under the principles of a chain system. This method of distribution provides an outlet for large quantities of merchandise, thus giving more purchasing power and closer contact with the central market. It further provides for a higher degree of specialization in particular lines of merchandise and a wider distribution of style risk. In the operation of several departments carrying the same line of merchandise, there may be developed standard methods of buying and selling, accounting, and stock control, which will result in all of the major advantages of a chain-store system.

On the other hand, there are certain outstanding weaknesses in such a chain. In many cases the policies of the chain company do not correlate with those of the store. The goodwill of the leased department is, after all, being built for the store, since there is no permanent equity for the lease owner. For this reason, short-time policies very often overshadow the

wiser long-time program. Successful department-store operation requires a uniform policy throughout. Either the local management must supervise the merchandising policy of the leased sections, or there is a lack of correlation of policies resulting in friction within the store. Another disadvantage in a chain of leased departments lies in the lack of correlation between buying and selling. Department stores in general may be able tc absorb a few leased department chains, but any considerable number will result in the disintegration of uniform store policies and a loss of institutional prestige.

Retailing will develop along those lines that give the closest coördination between customer demands and the facilities for meeting them. Close contact with the market and with the consumer must be maintained. The advantages of large-scale buying as enjoyed by chain stores, department stores, and associations will continue to be a factor in the development of retail types. With increased local competition, the study of customer demands—both actual and potential—will also be a factor in the development. The tendency then will be for unit stores to coördinate their activities through associations or to consolidate in the formation of chain stores. In the larger towns there will be, no doubt, a consolidation of non-competing department stores, in order to secure the dual advantage of department- and chain-store operation.

The problems of retail merchandising.—A brief survey of the retail field has served to indicate the wide range of merchandising problems which are involved in the different kinds of stores. Inasmuch as the functions of each of these types of stores are essentially the same, the problems of retail merchandising which are treated in the following chapters may be considered as pertaining primarily to internal operation only.

A major essential in the operation of a retail store is a sound functional organization of personnel and a physical classification and location of merchandise. The organization of personnel for merchandising purposes concerns itself with the allocation of responsibility for the proper performance of functions and the proper coördination of these functions for efficient performance. A consideration of merchandise classification not only effects better merchandising methods, but makes possible comparable figures between stores on a departmental basis. The possibilities of saving which may come

from a carefully planned location and layout of merchandise has given rise to a detailed study of the physical organization of a store.

The chief aim of merchandising is to sell commodities at a profit. In a study of store operation, therefore, attention is given to an analysis of the profit-and-loss statement and the elements which affect the net-profit figure. Before net profits can be determined, attention must be given to a classification of expenses and the distribution of these expenses to the different lines of merchandise in order to determine what general classes of goods are yielding profits. Since real profit is directly dependent upon the proper evaluation of stock, methods of obtaining accurate inventories are also included in the problems of merchandising.

The rate of stock turn reflects the degree of success that has been attained in effecting a smooth, regular flow of merchandise from producer to consumer. The problems of stock turn, therefore, involve the planning of stock and purchases in accordance with customers' demands, and the promotion of sales through personal salesmanship and advertising, in order to acquaint potential customers with the merits of the different commodities and the services which the store offers. The policy of stores in relation to employees, customers, and those from whom merchandise is purchased is also an important factor in merchandising effectiveness. Finally, the problems of retail merchandising include the use of current statistics in measuring progress in relation to other stores, in securing internal control, and in coördinating the store's activities with the business cycle. These problems will be the basis of separate discussion in the following chapters.

SUMMARY OF ADVANTAGES AND DISADVANTAGES OF DIFFERENT TYPES OF RETAIL STORES

Unit or General Store

Advantages	*Disadvantages*
1. Personal ownership.	1. Low borrowing power.
2. Personal contact with public.	2. Single location.
3. High-grade sales clerks.	3. Unorganized methods of buying and selling.
4. Stimulus of large profit.	4. Small purchasing power.
5. Low delivery expense.	5. Slow turnovers.
6. Low advertising expense.	6. Poor contact with the central market.
7. Ability to adjust policy to local conditions.	

Chain Store

Advantages	*Disadvantages*
1. Wide distribution of institutional prestige.	1. Lack of personal contact with clientele.
2. Organized methods of buying, accounting, and selling.	2. Unit managers inferior.
3. Large purchasing power.	3. Encourages speculative enterprises.
4. Efficient distribution of responsibilities.	
5. Diverse locations.	
6. Low delivery expense.	
7. Low advertising expense.	
8. Quick turnovers.	

Department Store

1. Advertising power.	1. High service costs.
2. Organized methods of doing business.	2. Single location.
3. Large purchasing power.	3. Inferior sales clerks.
4. Efficient distribution of responsibilities.	4. High delivery expense.
5. Quick turnovers.	5. High advertising expense.
6. Shopping facilities.	6. Public abuse of privileges.

Specialty Store

1. High-grade sales clerks.	1. Limited class appeal.
2. Specialization in merchandise and service.	2. High service costs.
3. Organized methods of buying and selling.	3. Single location.
	4. High advertising and selling costs.

Mail-Order House

1. Wide selling area.	1. High advertising expense.
2. Organized method of buying and selling.	2. High delivery expense.
3. Large purchasing power.	3. Lack of personal contact with customers.
4. Advertising power.	4. Risk because of price changes.

Chain of Departments

1. Large purchasing power.	1. Lack of coördination between buying and selling.
2. Distribution of risks.	2. Inability to maintain a uniform policy.
3. Closer contact with central market.	3. Lack of supervision of departments.
4. Organized method of buying and selling.	4. High cost of space.
5. More highly specialized buyers and style advisers.	

CHAIN OF DEPARTMENT STORES

Advantages	*Disadvantages*
1. Increased purchasing power of individual lines.	1. Decreased returns because of high cost of operation.
2. Ability to develop and use foreign markets.	2. Lack of co-ordination between buying and selling.
3. Saving in purchasing supplies and equipment.	
4. Distribution of style risks and buying services.	
5. Ability to make extensive research and experiments.	
6. More highly specialized executives in different lines.	
7. Continuity of management.	
8. Stability of capital through distribution of risks.	

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Problems.

1. Many writers contend that goods pass through the hands of too many middlemen on their way from producer to consumer. Other writers contend that there are too many retailers. We are told that the country is carrying an unnecessary burden in maintaining so many retail stores; that we pay too much for clerk hire, rents, and duplicating delivery systems; that the numerous failures among inefficient and poorly located retailers mean an added burden to the community.

Underlying this discovery, are certain assumptions: (1) that it ought to be possible to decide how many retailers there should be; (2) that there is some way of cutting down the number of stores; and (3) that if the number of stores were reduced, each would be handling a larger volume of business, and thus the cost of retail merchandising would be substantially reduced.

Are these three assumptions correct?

2. The index of annual sales for three different types of stores is shown in the table below. The mail-order houses include Sears, Roebuck & Co., Montgomery Ward & Co., Larkin Co., and The National Cloak & Suit Co. The five-and-ten-cent stores include F. W. Woolworth Co., McCrory Stores Corporation, S. S. Kresge Co., and S. H. Kress & Co. The department-store index includes the sales of 333 stores reporting to the Federal Reserve Board.

	Mail-Order Houses	*Five-and-Ten-Cent Stores*	*Department Stores*
1919	100	100	100
1920	103	118	120
1921	72	123	110
1922	79	141	111
1923	99	166	124

How may the difference in the fluctuation in sales volume of these different types of stores be accounted for?

3. The Hoyt department store is located in a town of approximately 60,000 in the middle west. During 1923 and the early part of 1924, house-to-house salesmen did a comparatively large business in this town in hosiery, brushes, aluminum cooking utensils, and other household articles. The local stores have become very much alarmed by the rapid growth of business done by direct-selling methods, and some merchants are in favor of taking some sort of action to prevent any further growth in the volume of direct sales. A lawyer has already informed the merchants that no legal action can be taken against the house-to-house salesmen. One of the merchants proposed that all of the stores coöperate in a city-wide sale in the merchandise in which direct-selling methods were used. Another proposal was that the stores put on an advertising campaign to encourage customers to patronize the local stores rather than outside concerns. The Hoyt store has an annual sales volume of $4,000,000, which is considerably larger than any other store in the city. Mr. Hoyt is chairman of the Retail Trade Board and has been called upon to express his opinions regarding the best method of competing with house-to-house salesmen.

What action should Mr. Hoyt suggest be taken by the retail stores?

4. In 1923 chain stores did about 8 per cent of the total retail business of the country, although they constitute only about 3.7 per cent of the total number of retail stores.

How may this relatively large volume of sales per store be accounted for?

5. Approximately 50 per cent of the total population of the United States is in the rural districts or in towns of less than 5,000 population.

What will be the probable development of stores serving the rural districts?

6. In a meeting of retail merchants in a New England city, the following statement was made: "There are thousands and thousands of men and women employed today, from coast to coast, by firms selling direct to the consumer. They are taking the trade right from under the eyes of the retail merchants in their immediate vicinity, and taking it from where the retail merchants expect their biggest business. Still, retailers in some districts do not wake up—they have a fair day Monday, Tuesday is dull, Wednesday about the same, Thursday no better, Friday some trade, and Saturday they are busy. What is to prevent a store employing, say, four clerks, from sending two or three clerks out to visit families in their immediate district, putting in full working hours, during Tuesdays, Wednesdays, and Thursdays?"

Would such a plan be feasible for the average retail store?

Chapter II

ORGANIZATION

The purpose of organization is to determine the scope of authority and to place definite responsibility for the proper performance of functions. In the smaller retail institutions, organization has been built around individuals rather than the functions they perform. But with the rapid growth in size of the department store and an increasing turnover in the executive personnel, there is a tendency toward the development of a somewhat standard form of organization, based upon the major functions which the retailer performs.

Administrative Organization.

The administrative control of a large store may be vested in a board of directors elected by the stockholders, an executive board or committee, a store council, a board of control, or a general manager. The executive board in one large store is composed of two members of the firm, four merchandise managers, the publicity director, the superintendent of the store, and the director of personnel. In a store in Boston, the executive committee includes the president of the company, the general manager, the store director, the director of finance and accounts, and the director of merchandise and publicity. In one large New York store the council consists of the three officers of the firm, the general manager, the controller, the advertising manager, and five merchandise men. In a store in Cleveland, the executive control is vested in a board consisting of the merchandise director, the store director, and the controller, who function only in the absence of the general manager.

Management.—Although there is no uniformity in the number of executives which compose the board of administrative control, nor in the name by which the body is known, the function is essentially the same in all stores—to formulate the

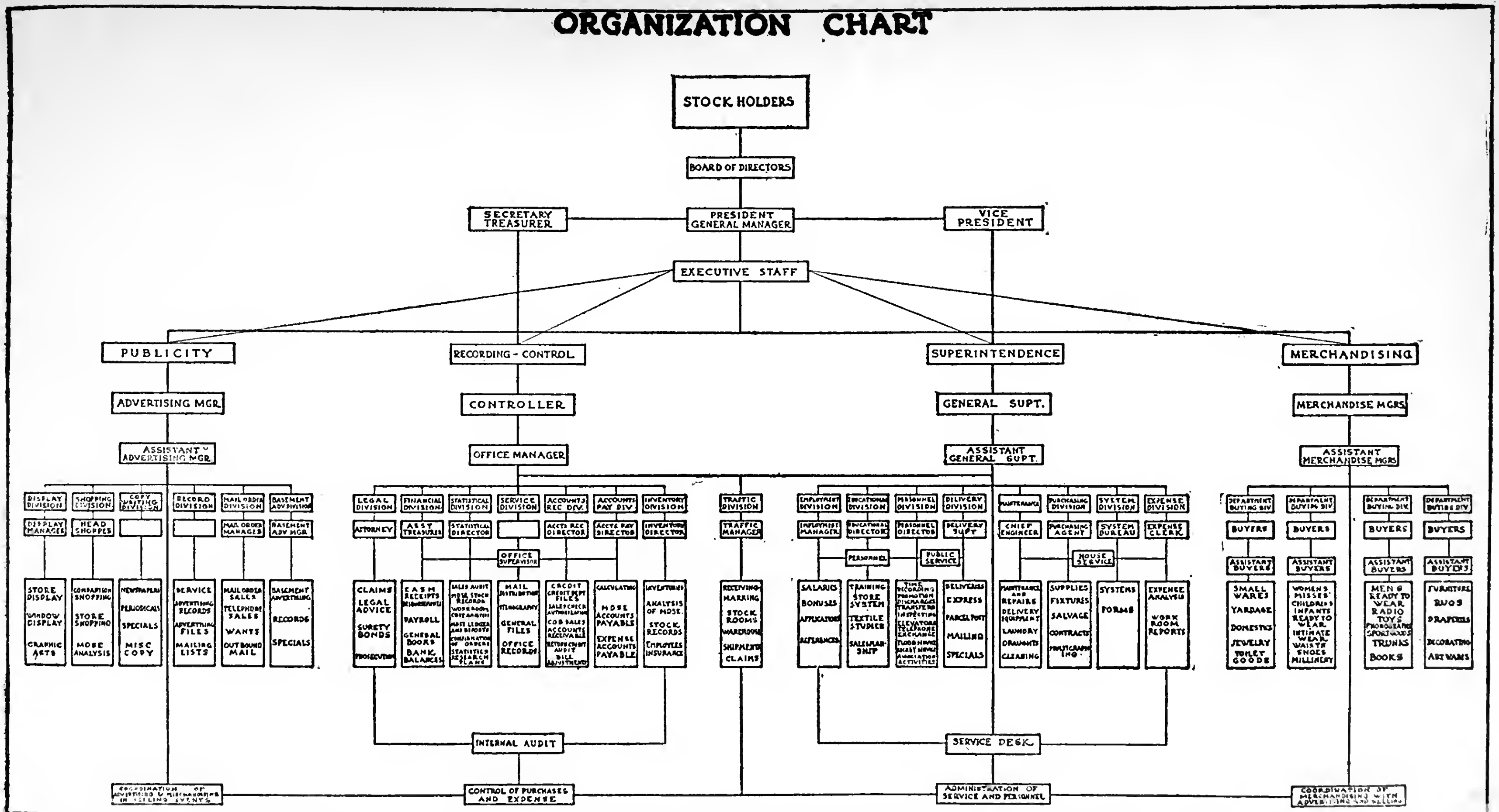

Fig. 2—Organization Chart.

major policies of the store and to provide for their uniform execution throughout all departments. The policies of a store are usually carried out by a general manager, whose function it is to harmonize and direct the activities of those under him, to act as a link between the officers of the company and all operating divisions of the business, and to carry out uniformly the policies of the store. In the smaller stores, owned and operated by a single individual, the formulation of policies and the execution of all functions are vested in one man, generally called the proprietor. A comparison of the functions performed by the proprietor of a small store with the functional divisions of a large store, as shown in Figure 2, will serve to indicate the fact that the most highly organized store is simply a subdivision of the natural functions which a small store performs.

Forms of organization.—As a general rule, the definite form of an organization is determined largely by the personality and capacities of the executives themselves. This is especially true in a store which has developed from the elementary type, where the head of the small store performed all functions, to the larger type in which various functions have been grouped under subordinate heads. A common type of organization in the larger retail store is that shown in Figure 2, in which the four major divisions—publicity, control, superintendence, and merchandising—are coördinated and supervised by a general manager. A chart of this kind definitely allocates the responsibility of the particular units; it shows the correct relation of one function to another, and indicates the scale of promotion and the opportunity for advancement. In some stores merchandise and publicity are combined under a sales-promotion manager. In a store in Boston there are two major divisions—merchandise and non-merchandise—with four subdivisions under each. The sales, publicity, merchandise service, and manufacturing departments come under the merchandise division; and service, maintenance, office management, and personnel, under non-merchandise. In one of the large stores of New York the management division is placed on a par with the merchandising, finance, and publicity divisions, as shown in Figure 3. In this store the board of operations, composed of the vice president of the corporation

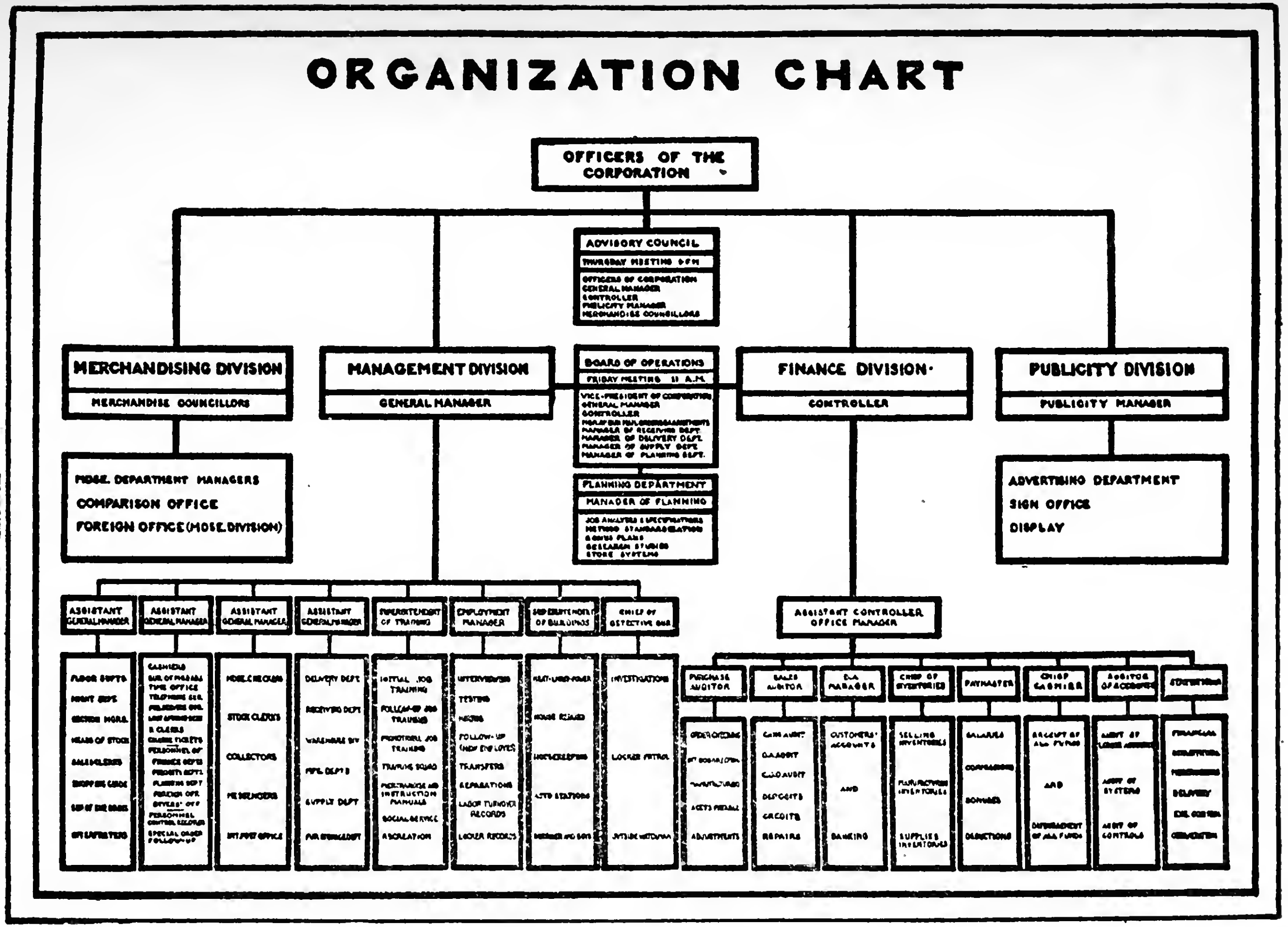

Fig. 3—Organization Chart.

and the heads of the service divisions, meet every Friday to discuss the problems of operation.

Publicity.—The publicity division may be in charge of a publicity director, a director of sales, or an advertising manager. The common practice in the larger store is to place the advertising manager on a par with the other three major divisions, as shown in the organization chart (Fig. 2). The advertising manager is responsible for the preparation and appearance of all printed matter used by the store in any medium, the purpose of which is to influence people favorably toward the store. He should coördinate the function of the advertising office with that of the buyers of the various departments and also with that of the general and divisional merchandise managers, so that a uniform policy may be maintained for the store as a whole.

Finance and control.—The financial division of an organization is centralized in the office of the controller, whose function it is to control the receipts and disbursements of all moneys; to audit all records of a financial nature, whether they concern merchandising, management, or publicity; to supervise the computation of all statistics which have to do with the major operations of the store; to furnish the merchandise division with such data and statistics as are necessary for the proper planning and control of merchandising operations; and to act in an advisory capacity in planning and research activities, and in insurance, tax, and financial matters. A more detailed subdivision of the controller's functions are shown in Figures 2 and 3.

Superintendence.—The general superintendent, sometimes called store manager or store superintendent, is in active charge of all physical handling of merchandise from the time it is received until it is ultimately sold to the customer. In addition, he is in charge of all service which the store renders its customers and all personnel required to render this service. A third function of the superintendent is the care of buildings and equipment. The general superintendent, as a rule, has a number of assistants, each in charge of a particular function as shown in Figures 2 and 3. The employment division has charge of the selection of employees, their physical and mental testing, and the proper recording of their performance. The educational division is concerned with the training of em-

ployees in system and salesmanship, and in their specialized development for general efficiency and for promotion. Upon this department usually falls the responsibility of looking after the general goodwill and welfare of all employees as well as their training. In some stores the personnel department, under the direction of the personnel manager, has supervision of employment, education, and welfare. The receiving, marking, and storing of merchandise is generally under a receiving manager who may be responsible either to the general superintendent or to the controller. Other functions falling under the supervision of the general superintendent are those of delivery, which includes the packing and wrapping of merchandise; the adjustment of all complaints, credits, refunds, and repairs; and the maintenance of buildings and equipment, which includes lighting, ventilating, heating, cleaning, and repairs.

To aid in the supervision of selling, the store superintendent has an assistant superintendent in charge of each floor. These floor superintendents supervise the work of the salespeople through section managers, sometimes called aisle managers or "floor walkers." The service to customers varies with the policy of the store. In the larger store it includes, in addition to the major services, rest rooms, writing rooms, check rooms, restaurants, shopping guides, and interpreters. It is the duty of the general superintendent to supervise all of these minor functions, enforce all rules, keep expense at a minimum, and supervise the protection of merchandise during and after store hours.

Merchandising Division.

Merchandising is the process or function of buying and selling merchandise quickly and profitably; of maintaining the most advantageous proportion between sales, stocks, and profits; and of controlling the relation between purchases and estimated future sales. The merchandising division is responsible for the proper performance of the function of merchandising. The present status of the general merchandise manager, as found in the larger department stores, may be better understood by a brief survey of the conditions which gave rise to his position. As the unit store grew in size and increased the number of lines of merchandise carried, it was

necessary for the proprietor or owner to have assistance in the buying of different lines. He first used the more reliable clerks to inspect goods submitted by the traveling salesmen. This responsibility was enlarged in proportion to the success with which the selections were made, and eventually the proprietor designated a buyer for specific lines, thus introducing specialization with its logical sequence, the segregation of departments within the store, which has resulted in the development of the modern department store. In the smaller stores the activities of the buyers could be supervised by the proprietor himself, who performed the function of the person now known as general merchandise manager. But, as the store increased in size and in the number of its departments, the merchant lost his contacts with the markets, and the next step was the creation of the position of merchandise manager.

The major duties of the general merchandise manager are: (1) to coördinate the activities of the individual buyers in carrying out the policies of the store; (2) to supervise and apportion funds among the buyers so as to maintain the most representative stock possible with a minimum investment; and (3) to assist the buyers in the promotion of sales. The larger stores usually have a centralized merchandise control under the general merchandise manager and a divisional control of related groups of merchandise under divisional merchandise managers. The departments may be grouped according to their location on the different floors, or according to the nature of the merchandise. The latter is usually preferable, in that it permits closer coördination of the activities of buyers whose lines are interdependent. A common grouping for divisional control is: women's ready-to-wear, small wares, piece goods and domestics, home furnishings, men's departments, sporting goods, furniture and rugs, and art wares.

In a department store each buyer, presumably, should be able to merchandise his own department. In actual practice, however, most buyers are poor manipulators of stock. They are close to the clamor of consumer demand and are beset with the insistent offerings of salesmen. They are specialists in particular lines of merchandise, but usually need supervision in the planning and the operation of their departments. From an organization point of view, the divisional merchandise manager is the executive charged with the supervision of a

group of buyers and assistant buyers. He is responsible for the coördination of the activities of the buyers under his supervision and for the correlation of his own merchandise division with the other divisions of the store. In a store having seventy buyers, the merchandise activities may be supervised by seven divisional merchandise managers, each having ten buyers in the group. In this way the general merchandise manager may deal directly with seven men rather than with seventy. Merchandising policies may be more easily formulated and executed, where there are established clear and direct lines of authority and supervision.

Divisional merchandise managers are responsible for seeing that the general policies of the store are carried out as formulated by the executive committee. Each, in coöperation with his buyers, is responsible for making the merchandise plans governing the operations of his departments. In carrying out these duties the divisional merchandise manager should act as adviser and critic. Properly to perform these functions, he should have a general knowledge of an adequate turnover, mark-up, percentage of reductions, inventory shrinkage, and percentage of overhead in each department. After his plans are made his function is to see that adjustments are made in accordance with the variations of actual performance from planned figures. The adjustment of purchase limits should be supervised in such a way that the divisional merchandise managers will have control over the buyers' activities and at the same time not interfere with the proper function of buying.

In seeing that uniform policies are carried out, the divisional merchandise manager should visit the receiving room and see that the merchandise of his departments is in keeping with the standards of the store and that invoices carry a mark-up that will insure a fair profit. In order properly to supervise the buying of goods and the planning of future purchases, the divisional merchandise manager should be familiar with the principal sources of supply for all his departments, as to time required for delivery, relative status of the different sources, and the relation of the immediate sources, such as jobbers, importers, and wholesalers. He should also be familiar with the primary markets in which merchandise may be bought to the best advantage. Inasmuch as the buyer, as a rule, is more highly specialized in a certain type of merchandise and more

familiar with certain markets than the divisional merchandise manager could be, the function of the latter is to act as adviser in attempting to broaden the buyer's knowledge of the markets and sources of supply.

In maintaining a uniform policy between the store and vendors, the divisional merchandise manager supervises the terms, discounts, and general relations between buyers and salesmen, so as to avoid long-time contracts and to be in a position to render an intelligent decision in case of controversies arising out of unethical or questionable practices on the part of the buyer or salesman. To perform this function properly he should accompany the buyer into the market from time to time so as to keep in close contact with market conditions. In most stores it is his function to approve all buyers' orders, and in the exercise of this function the operation of each department should be studied in detail. If he approves or disapproves orders he should have first-hand knowledge of the conditions which gave rise to the orders.

In carrying out the uniform policies of the store, the divisional merchandise managers supervise all selling activities and sales promotions. Properly to perform this function, they should have a thorough knowledge of the district in which their merchandise is sold, of the nature of the consumer demand, and of the characteristics of the store's clientele. With the aid of the buyers and the comparison office, they should know at all times the relative status of the different departments, compared with those in other stores, as to price ranges, values, completeness of stocks, display, and the general selling efficiency of the salespeople. It is their duty to train buyers and their assistants so that they may perform as many of the merchandise functions as possible for their own departments. The ideal arrangement is one in which each buyer merchandises his department and simply uses the divisional merchandise manager as an adviser.

The proper performance of these functions demands that the divisional merchandise managers should understand the personalities of the buyers under their control, for, to a large degree, it is through their influence and their direction of the buyer's activities that the function of buying is most efficiently performed. With the increasing importance of planning merchandise activities of a department and store, the functions of

the general merchandise manager and his assistants are growing in importance. It is through the proper performance of their functions that merchandising will become more scientific. Their success will depend upon how well they record the essential facts of a business, analyze them, prevent a repetition of error, and carry out the ventures which have proved successful.

When the merchandise managers first made their appearance they were looked upon by some salesmen with disfavor, because it was their duty to approve all orders of buyers before goods could be received by the store. However, as their functions are better understood by buyers and salesmen, they are looked upon with more favor. Salesmen realize that their success and reputation with a store depends upon how closely the buyer purchases in accordance with his needs as worked out in a merchandise plan. This was especially emphasized during the latter part of 1919 and all of 1920, when the average buyer suffered a severe loss because of heavy stocks and a quick fall in prices. Since 1920, the tendency in stores has been to adopt a hand-to-mouth buying policy, so as to maintain complete stocks with minimum investments. This has required, in addition to the selection of merchandise, a careful supervision of inventories, to detect slow-moving lines and to fill in low stocks.

Buyers.—In the larger stores a buyer is usually in charge of a department or of several closely related departments. In the smaller stores he may have control of several departments or lines of merchandise. His function is to buy the merchandise and to assist in the selling. In some stores, buying and selling are divided so that the buyer's function is completed when the merchandise has been purchased. The common practice, however, is to coördinate the two functions and have the buyer assist in the selling, (1) that he may have an opportunity to study his customers and thus anticipate their wants more intelligently, and (2) that he may feel a greater responsibility in the selling of goods that he has bought. He thus becomes a department manager and in some stores he receives this title rather than that of buyer. The major functions of the buyer are: (1) to operate his department so that his merchandising activities may be correlated with those of other departments; (2) to select merchandise in accordance with his plan; (3) to price the merchandise and to make such adjustments in price

through mark-ups or mark-downs as will keep the merchandise in line with the policies of the store; (4) to plan and assist in advertising and sales promotions; (5) to be responsible for the appearance of the department as to display and condition of stock; and (6) to be responsible for a reasonable gross margin and net profit.

There is a conflict of opinion in regard to the scope of authority of the buyer and the section manager. For example, in case a customer wishes to return a garment, whose opinion should be final, the merchandise division or the superintendence division? The answer to a question of this kind naturally is dependent upon individual organizations. As a general rule, however, in making adjustments, the buyer should present the expert knowledge regarding the merchandise, but the final adjustment should rest with the section manager or floor superintendent who presumably is more able than the buyer to weigh the circumstances with an unbiased mind. Another line of responsibility and authority which is difficult clearly to define is that which exists between the buyer and the merchandise manager or, in the larger store, the divisional merchandise manager. To what extent should the buyer be just a selector of merchandise to fit a prearranged merchandise plan and to what extent should he determine the amount of merchandise and the time of purchases? It may readily be seen that the planning and the selection of merchandise cannot be clearly separated, as they are mutually interdependent functions. For this reason, the emphasis of most progressive stores has been more to educate the buyer to do his own planning and merchandising, the merchandise manager acting only in an advisory capacity. Usually there is an assistant buyer who aids in carrying out the function of the buyer by interpreting the demands of customers and by supervising the care of stock and the perpetual piece-control systems.

Comparison department.—As an aid in maintaining merchandise values and store service in line with that of competing organizations, some stores have a shopping or comparison department. This department may be under the supervision of the merchandise division, the service division, or the general manager. The function of this department is to compare the merchandise service and the general atmosphere of a store or department with that of competing stores at frequent intervals

and to make purchases which show the qualities, styles, and prices of seasonal goods offered for sale. The effectiveness with which a store caters to the shopping habits of customers is measured directly by the degree with which it maintains competitive merchandising efficiency. The shopper is supposed to take the customer's point of view and to make comparison between the home store and competing stores in all things which may affect the customer's attitude toward the store. The reports of the shopper should be unbiased and unhampered by the influence of any departmental executive. It seems logical, therefore, that the comparison department should be responsible to the general manager or to a member of the firm.

Merchandise Classification and Departmentalization.

To have proper control of the merchandising activities of the larger retail store, it is necessary to divide the merchandise handled into classes or lines, so that the merchant may know from what source he receives profits and from what lines he is suffering losses. To secure this information, it is necessary to keep separate records of sales and the cost of sales for each line or classification. The acceptance of this practice has resulted in a physical separation of lines into departments, which are operated as individual units in the larger stores. In order to keep a merchandise control by departments, separate records must be made of net purchases, net sales, inventories, and price changes. These figures give the gross margin of each department from which equitable expenses are subtracted to get net profit. These data indicate the degree of success with which each department is managed and provide the bases for planning future purchases and mark-ups.

The number of divisions into which merchandise is classified in a particular store depends chiefly upon the volume of sales and the necessity for separate records for merchandising purposes. Ordinarily, it is necessary to have a substantial volume of sales for each class of merchandise before a store is warranted in keeping separate records for the sales, purchases, and inventories in order to ascertain gross margin and stock turn. It is practical, however, to departmentalize the merchandise accounts for sales, purchases, and inventories with a

CLASSIFICATION OF MERCHANDISE

Group I *8 Departments*	*Group II* *34 Departments*	*Group III* *58 Departments*	*Group IV* *122 Departments*
Dry Goods	Silks	Silks Velvets	Colored Silks Black Silks Velvets
	Dress Goods	Woolen Dress Goods Wash Dress Goods	Black Dress Goods Colored Dress Goods Patterns Linings White Wash Goods Colored Wash Goods
	Linens and Domestics	Linens Domestics	Linens Cottons and Sheetings Blankets and Comforts
	Laces, Trimmings, and Embroideries	Laces, Trimmings, and Embroideries	Laces Trimmings Embroideries
	Neckwear and Veilings	Neckwear and Veilings	Neckwear Veilings
	Ribbons	Ribbons	Ribbons
Small Wares	Notions	Notions	Notions
	Toilet Articles	Toilet Articles and Drugs	Toilet Articles Ivory Drugs
	Handkerchiefs	Handkerchiefs	Handkerchiefs
	Silverware and Jewelry	Silverware and Jewelry	Silverware Jewelry
	Leather	Leather Goods Umbrellas, Parasols, and Canes	Leather Goods Umbrellas, Parasols, and Canes
	Art Needlework and Art Goods	Art Needlework and Art Goods	Art Needlework Art Goods
Men's and Boys' Wear	Men's Clothing	Men's Clothing	Men's Clothing
	Men's Furnishings	Men's Furnishings Men's Hats and Caps	Men's Furnishings Hats and Caps Robes and Smoking Jackets

CLASSIFICATION OF MERCHANDISE—*Continued*

Group I *8 Departments*	*Group II* *34 Departments*	*Group III* *58 Departments*	*Group IV* *122 Departments*
	Boys' Wear	Boys' Clothing Boys' Furnishings	Boys' Clothing Boys' Furnishings Boys' Hats and Caps
Women's and Misses' Ready-to-Wear	Coats, Suits, and Skirts	Coats Suits Skirts	Women's Coats Women's Suits Women's Skirts Women's Dresses Women's Stouts
	Dresses	Dresses Misses' Wear	Misses' Coats Misses' Suits Misses' Skirts Misses' Dresses
	Furs	Furs Fur Storage	Furs Fur Storage
	Juniors' and Girls'	Juniors' and Girls'	Juniors' and Girls' Coats Juniors' and Girls' Suits Juniors' and Girls' Skirts Juniors' and Girls' Dresses
	Waists, Sweaters, and Knit Goods	Waists and Blouses Sweaters and Knit Goods	Waists and Blouses Sweaters and Knit Goods Sports Wear
Women's Ready-to-Wear Accessories	Millinery	Millinery	Millinery
	Gloves	Gloves	Ladies' Gloves Children's Gloves
	Corsets, Hosiery, Knit Underwear Muslin Underwear, and Infants' Wear	Corsets and Brassières Hosiery Knit Underwear Muslin Underwear Infants' Wear	Corsets and Brassières Ladies' Hosiery Children's Hosiery Knit Underwear Muslin Underwear Bathing Suits Infants' Wear
	Petticoats, Negligées, and House Dresses	Petticoats, Negligées, and House Dresses	Petticoats Negligées Aprons, House Dresses

CLASSIFICATION OF MERCHANDISE—*Continued*

Group I *8 Departments*	*Group II* *34 Departments*	*Group III* *58 Departments*	*Group IV* *122 Departments*
Shoes	Women's and Children's Shoes	Women's Shoes Children's Shoes	Women's Shoes Children's Shoes
	Men's and Boys' Shoes	Men's and Boys' Shoes	Men's Shoes Boys' Shoes
			Shoe Shine Repairs
Home Furnishings	Furniture, Beds, etc.	Furniture, Beds, etc.	Furniture Beds, Mattresses, and Springs
	Floor Coverings	Rugs Carpets, Linoleums and Mattings	Oriental Rugs Domestic Rugs Carpets Linoleums and Mattings
	Draperies and Lamps	Draperies and Lamps	Draperies Lamps Shades Art Wares Decorating Wall Paper
	China and Glassware	China and Glassware	China and Glassware
	House Furnishings	House Furnishings	House Furnishings Pictures and Picture Framing Sewing Machines Electrical Equipment
Miscellaneous	Toys and Luggage	Toys and Sporting Goods Luggage	Toys Sporting Goods Camera Supplies Luggage Automobile Supplies
	Books and Stationery	Books and Stationery	Books and Magazines Stationery
	Talking Machines	Talking Machines, etc.	Talking Machines Records and Rolls Pianos and Piano Players Sheet Music

CLASSIFICATION OF MERCHANDISE—*Continued*

Group I *8 Departments*	*Group II* *34 Departments*	*Group III* *58 Departments*	*Group IV* *122 Departments*
Miscellaneous (*Continued*)			Washing Machines Vacuum Cleaners Optician and Optical Goods
		Candy	Candy Soda Fountain
		Restaurant	Restaurant
Basement Store		Ready-to-Wear	Coats Suits Skirts Dresses Waists
		Ready-to-Wear Accessories	Corsets Hosiery Knit Underwear Muslin Underwear
		Millinery	Children's
			Millinery
		Shoes	Small Wares Piece Goods
			Shoes
			Draperies

smaller volume of sales than is essential for departmentalizing expense. For example, a store may keep separate records of sales, purchases, and inventories for ties, collars, and shirts in order to determine the relative gross margin on each of these lines, whereas, usually, the allocation of expenses to each of these lines is not practical. Similarly, in a small dry-goods store where salespeople make sales in all departments of the store, it is not practical to allocate wages to the different lines. As soon as the volume of sales in the various lines increases to a point so that individual salespeople can sell regularly in the same departments, their wages can be charged directly to the respective departments. As a general rule, a distribution of expense should be made only under such conditions that the

major expenses may be found for each department without an arbitrary allocation.

Standard classification of merchandise.—In order that accurate comparison may be made between different stores, the Controllers' Congress of the National Retail Dry Goods Association in 1922 published the standard classification of merchandise given above for each of four groups of stores. This classification provides 8 departments for Group I, which comprises small stores; 34 for Group II, stores of the next larger size; 58 for Group III, the next larger stores; and 122 for Group IV, the largest stores. Under this classification all small wares, for example, are included in one department in the small store and in twelve departments for the large store in Group IV. In these classifications the natural divisions of merchandise have been followed in so far as possible, so that the departmentalization of merchandise for purposes of control would not interfere with the layout of the selling floor, or customer convenience in selecting allied lines. The standard classification of merchandise has been generally adopted by the larger retail stores, so that the interchange of comparable figures by major classification is now possible. The common percentage of sales in each department to total sales of the store for 1923 is shown by Table 2 below.

TABLE 2

SALES BY DEPARTMENTS IN TWENTY-FOUR STORES

Departments	*Per Cent to Total Sales Common Figure*
Silks and velvets	6.74
Dress goods	3.89
Linens	2.44
Domestics	2.58
Laces, trimmings, embroideries	1.65
Neckwear, veilings	1.00
Ribbons	.88
Notions	1.63
Toilet articles, drugs	2.95
Handkerchiefs	.52
Silverware, jewelry	1.76
Leather goods	1.08
Umbrellas, parasols, canes	.29
Art needlework, art goods	1.90
Men's clothing	3.28
Men's furnishings	3.25

TABLE 2—*Continued*

SALES BY DEPARTMENTS IN TWENTY-FOUR STORES

Departments	*Per Cent to Total Sales Common Figure*
Men's hats and caps	.32
Boys' wear	1.59
Women's coats	3.32
Women's suits	1.63
Women's skirts	.96
Women's dresses	5.12
Misses' ready-to-wear	2.19
Furs	1.48
Juniors' and girls' ready-to-wear	1.16
Waists and blouses	1.71
Sweaters	1.18
Millinery	3.52
Gloves	1.20
Corsets and brassières	1.95
Hosiery—women's and misses'	3.37
Knit underwear	1.21
Muslin underwear	2.30
Infants' wear	1.91
Petticoats, negligées, aprons, house dresses	1.87
Shoes—women's, children's, men's and boys'	4.96
Furniture	4.97
Rugs, carpets, linoleums, mattings	4.27
Draperies, lamps	4.33
China, glassware, housefurnishings, washing machines, vacuum cleaners	4.81
Toys, sporting goods, luggage	1.24
Musical instruments, talking machines and records	1.32

Basis of classification.—The basis of classification should be determined from the point of view of (1) merchandise control, (2) accuracy in accounting procedure, and (3) sales strategy. For the purpose of control, merchandise is classified or subdivided according to general similarity in such characteristics as use, source of purchase, constant or seasonal demand, staple or novelty. The major classifications so determined are furniture, home-furnishings, women's and misses' ready-to-wear, hosiery, shoes, men's and boys' wear, and piece goods. For accuracy in accounting procedure, merchandise is classified according to its general similarity, not only as to use, but as to average mark-up and rate of turnover. This is especially true in stores using the retail method of inventory, which is explained in a later chapter. Sales strategy includes (1) the proper layout of a department to get display value and con-

venience to the customer; (2) the location of the different lines, so as to utilize space, to take advantage of actual traffic, and to create customer traffic; and (3) the grouping of allied lines, so as to get a maximum of sales through suggestive selling.

Location of departments.—The factors governing the location and the layout of merchandise in a store are: (1) type of merchandise; (2) lines of customer traffic; (3) convenience to customer and salespeople; (4) value of space; (5) display value; and (6) merchandising and sales policy. From the standpoint of the consumer's buying habits, merchandise sold in retail stores may be divided roughly into three classes: (1) shopping goods; (2) convenience goods; and (3) impulse goods. Under these classifications the initial step in finding the proper location for a particular commodity is to determine whether ordinarily it will be purchased by consumers with or without shopping, at places immediately convenient or on the upper floors.

Shopping goods.—Shopping goods are those for which the customer desires to compare prices, quality, and style at the time of purchase. Usually, the customer wishes to make this comparison in several stores and will readily go to any part of the building to find the merchandise. Trimmed millinery, furniture, and women's and men's ready-to-wear fall under this group. The line of demarcation between various classes of consumers' goods, however, is not always clear. Low-price hosiery and staple dry goods are examples of commodities that are merchandised both as shopping goods and as convenience goods. The purchase of shopping goods by a customer usually may be deferred for a time after the desire to make a purchase has been felt. Obviously, departments carrying shopping goods may be located on the upper floors and in less accessible places than non-shopping merchandise.

Convenience goods.—Convenience goods are those customarily purchased at easily accessible stores and convenient locations within the stores. The success of the neighborhood store and of the corner cigar store depends directly upon the factor of convenience to customers in purchasing. The process of purchasing convenience goods is first the conscious recognition on the part of the customer of a need for an article, and then the determination immediately to satisfy the want.

Umbrellas, for example, are usually purchased during rainy weather when the need for them is immediate, and for this reason they should be placed in the most accessible place in the store. It should be emphasized at this time, however, that the real test of the classification of merchandise is the state of mind of individual customers and their attitude toward the merchandise. For instance, some men shop for ties. Likewise, many women shop for groceries and hosiery. For this reason, merchandise cannot be placed definitely in any one classification. The general policy of placing convenience goods in the most convenient locations is the most satisfactory one to follow for all stores. Contrary to this policy, however, one store in New York places its grocery department on the fifth floor without any special elevator service. This store has specialized in high-grade and complete lines of groceries at lowest-in-the-city-prices, so that the department draws customers through the store, and thus groceries in this store cease to be convenience goods.

Impulse goods.—Impulse goods are those for which the desire arises because the goods are seen. The best example of this type of merchandise is that which is displayed in subway stands and railway terminals, such as candies, nuts, and fruit. The average sale in impulse goods is obviously smaller than that in either shopping or convenience goods. Departments carrying impulse goods should be located in the main stream of traffic, if they are to get the maximum sales and maintain a high turnover. Cigars and cigarettes fall under both the convenience and the impulse classifications. Convenience is a major consideration in choosing locations for cigar stores. A large percentage of the sales in such stores, however, is made because of window display.

Specialty goods.—Any of the three types of merchandise may be featured by the store in such a way as to make it specialty goods. For the customer, the goods may have some particular attraction other than price, which induces him to put forth special effort to visit the store in which they are sold and to make the purchase without shopping. For instance, in the store mentioned above, groceries were specially featured and should be classed under the heading of specialty goods. Ordinarily, men's collars and ties cannot be economically sold off the first floor. In some stores, however, they are placed

on the upper floor with men's clothing and made accessible by special express elevator service. As a general rule, the breaking down of customers' buying habits cannot be justified from a merchandising point of view.

Customer traffic.—The number and location of entrances, elevators, and escalators determine to a large degree the natural flow of customer traffic through the store. This is especially true of traffic on the main floor. In some stores a traffic chart is prepared showing the relative number of customers which use the different aisles. On the basis of the chart the departments are located so as to get the maximum attention for seasonal goods and rapid turnover of impulse merchandise. Under ordinary circumstances traffic has a tendency to bear to the right. This is a habit arising from the general principle of traffic movement on the sidewalks, streets, and roads of this country. It is possible to offset this tendency by arranging aisles and tables so as to direct people when they first enter the store. As a general rule the traffic should be "split" by placing a counter or table at the main entrance. There is a diversity of opinion as to whether the relative number of men and women on the different aisles should be a factor in locating departments. For instance, the men's furnishing department presumably should be located on the aisle which is used by the greatest number of men. Actual figures, however, show that women buy more collars, shirts, and ties than men, so that, in the department store, the sex need not be made an important factor in layout.

Value of space.—Another consideration in locating a department is the value of space as affected by the number of people passing. The success of a store to a large degree depends upon getting a maximum number of purchases from the customers who enter the store. For instance, if convenience and impulse goods are placed on the upper floors and shopping goods on the main floor, the sales in the former would materially decrease, whereas the sales for shopping goods would not show a corresponding increase. It is recognized that there are certain locations which offer greater sales possibilities than others. The problem of layout is to place the type of merchandise in the position that will give a maximum of the potential sales for the store as a whole. Since the space near the main entrance has a large volume of traffic,

it should be charged a higher rent and merchandise having a high rate of stock turn should be located in this space. Because of its display value, however, jewelry and silverware are usually placed near the main entrance, although this type of merchandise in most stores has a very low rate of stock turn.

Allied lines.—Another factor to be considered in the layout of a store is the relative position of allied lines of merchandise. Allied lines are those which are suggested by the purchase of other merchandise. For example, when a man buys a shirt he is a potential customer for collars and ties and, by having these departments conveniently near, sales are promoted. Departments are usually grouped along horizontal lines, that is, related lines are grouped as nearly as possible on the same floor. In some stores a vertical grouping is followed. In one store in Boston all shoe departments are placed directly above one another on the different floors. A similar plan is followed for the stout-wear sections. On the ready-to-wear floor there is a stout section, and on the floor above, in the same relative position, is a section devoted to blouses for stout women. Directly beneath is the section for large-size corsets. By this type of layout a maximum advantage is taken of suggestive selling.

General rules for layout.—In so far as possible, a store should be laid out in such a way that only potential and actual customers need be carried to the upper floors. Convenience and impulse or pick-up merchandise should be placed on the main floor. These items will include most merchandise of daily demand and rapid-selling lines. Novelty merchandise and goods which have a short selling period should also be placed on the main floor and on aisles with high traffic. As a general rule, merchandise which requires fitting, such as shoes, ready-to-wear, and millinery, should be on the upper floors, so that there may be more space and privacy. Merchandise requiring a large amount of space for display, such as furniture and floor coverings, should be on the upper floors which have a low rental value. Merchandise with display value should be placed near the entrance to each floor, especially near the main entrance on the first floor.

The lines of merchandise carried in the basement depend upon the merchandise policy of the store. In a downstairs

store the policy is to duplicate, in so far as possible, the lines carried upstairs. Another factor that has to be taken into consideration in store layout is the general location of departments in other stores of the community. This is especially true in the case of shopping goods in which the customer desires to compare price, style, and quality. Although no standardized procedure in layout has been adopted, most stores conform to the general principles laid down above, so that merchandise may be found in about the same location in different stores. This facilitates the location of merchandise by customers and very greatly decreases the congestion in aisles due to customers passing through departments in search for other lines of merchandise.

The methods of store layout and merchandise arrangement in chain stores are standardized, as a general rule, and are superior to the physical merchandising plans of the average unit store. The United Cigar Stores Company, for example, made special studies to ascertain which articles were called for most frequently and how the merchandise should be arranged on the counters and shelves in order that customers could be served most expeditiously. It is recognized that the success of stores handling convenience goods is directly dependent upon quick service as well as convenient location. The merchandising strategy of the five-and-ten-cent store companies has contributed largely to their success. All the merchandise is displayed on counters where it may be inspected readily by customers. Inasmuch as most of the merchandise carried by these stores is purchased on impulse, their problem is one of efficient display rather than of personal salesmanship.

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Problems.

1. The J. C. Penney Company, which operates a chain of stores chiefly in small towns, has increased from 197 stores in 1919 to more than 500 in 1923. The manager of each store holds a one-third interest in the store of which he has charge. Each new store that has been established is an offshoot of a previously established store, and the manager of the store under whose auspices a new store has been started also has received a one-third interest in the new store. Thus, if a new store is designated as C, the store from which C was an offshoot as B, and the store from which B was an offshoot as A, the managers of stores A, B, and C each hold a one-third interest in store C. The stores in this chain sell only staple merchandise for cash. The accounting and finance are centralized in the parent company and that company buys the merchandise for all the stores. Store managers are admitted to partnership as soon as they have proved their ability to manage new stores successfully.

What is the particular advantage in an organization of this kind?

2. The Durwell department store has an annual sales volume of approximately $12,000,000. This store is owned by Mr. Durwell, who has been actively in charge of it, since it was founded twenty years ago. In the present plan of organization the merchandise manager, controller, and superintendent report directly to Mr. Durwell. The advertising manager is responsible to the merchandise manager. Recently Mr. Durwell decided to retire and leave the business in active charge of the superintendent who will act as general manager. He has decided to place the advertising manager on a par with the merchandise manager, controller, and superintendent. Mr. Durwell wishes to draw up an organization chart which will clearly define the responsibilities of the four chief executives.

Under what heading should the following be placed?

Comparison department.	Credit department.
Window display.	Adjustment department.
Telephone operators.	Packers.
Returned goods room.	Salespeople.
Porters.	Cash audit.
Rest rooms.	Merchandise signs.
Section managers.	Receiving room.
Employees' restaurant.	Marking room.

3. The Hale department store is located in a large city in Ohio. It does a business of approximately $15,000,000 annually and appeals to medium and high classes of trade.

(*a*) This store has a large lot of women's untrimmed hats to be sold at very low prices. It is planning to put these on special tables, so that

the customers may handle them and try them on. The untrimmed millinery department is on the sixth floor and caters to a high class of trade. On what floor and in what position on the floor should the untrimmed hats for the special sale be placed?

(*b*) The Hale store is noted for its high-grade women's hosiery. At the present time the hosiery department is located near the shoe department on the second floor. The management is considering moving the hosiery department to the front part of the main floor. Should the hosiery department be moved to the main floor?

(*c*) This store carries a line of medium- and low-priced dresses. Should these dresses be located near the high-priced lines?

4. The Wells department store, located on the Pacific coast, recently proposed to change its form of organization in order to permit more emphasis to be placed on the selling of merchandise. The yearly sales volume of this store is approximately $14,000,000. It specializes in women's ready-to-wear and features merchandise that makes a direct sales appeal. The present form of organization is similar to that in Figure 2. The proposed plan calls for separation of the buying and the selling functions. The chief function of the buying division would be to purchase merchandise and to have it delivered as promised. The selling division would receive merchandise, mark it in accordance with prices stated by the buyer, and be in charge of all selling operations, leaving the buyer free to concentrate his attention solely upon the purchasing of satisfactory merchandise.

A change of organization is also contemplated by the Fair store located in a city near New York. This store is similar in organization, size, and character of merchandise to the Wells store. In the Fair store it is proposed to place the buyer in complete control of both buying and selling; in other words, to make him the department manager. This store feels that the responsibility of the buyer should continue until the merchandise is sold. It is felt that if the functions are separated it will give an opportunity for each division to pass the blame for slow-moving merchandise, whereas to make the buyer responsible until the merchandise is sold will have a tendency to encourage better coördination between current demands of customers and the merchandise purchased.

Should the proposed changes be made in each of the two stores?

5. In the Wells department store, salespeople are required to keep a record of merchandise which is asked for by customers and which is not in stock. These records are kept on "want" slips and are turned in each evening to the section manager who sends them immediately to the office of the divisional merchandise manager. At the weekly meeting of the buyers the merchandise manager reviews the number of calls

which have been made for merchandise not in stock. Consequently, some buyers look upon the want slip as a criticism of their buying efforts and have discouraged salespeople from filling them out. In another store the calls for merchandise not in stock are recorded immediately in duplicate, one copy going to the buyer and one to the merchandise manager. The merchandise manager of the Wells department store feels that one copy of the want slip is sufficient, although he is not satisfied with the results of its present use in his store.

What changes should be made in the use of the want system in the Wells store?

6. In the Wells department store the comparison department is directly responsible to the merchandise manager. The shoppers from the department visit competing stores at frequent intervals to make purchases which show styles, qualities, and prices. These shoppers also observe merchandise and store arrangements, compare the courtesy of salespeople, and the general efficiency of service. The reports of the shoppers are made in great detail and a copy is sent to each of the division heads to which the report pertains. The superintendent and the publicity director of the Wells department store have recently complained that the comparison department is giving too much of its time to merchandise shopping and is not sufficiently available for service shopping. It has been recommended that two or three shoppers from the comparison department be assigned to the service department. Another proposition is that the comparison department report directly to the general manager rather than to the merchandise manager.

To whom should the comparison department report?

Chapter III

EXPENSES AND PROFITS

The first essential in the operation of a retail business is that it adopt some method whereby it may accurately determine the margin that exists between sales and cost of sales. The success of all merchandising activities is measured, to a large degree, in terms of profits. The possibility of securing net profit is the inducement which leads men to engage in business on their own account rather than to seek employment with others. It is, therefore, the motive force of the competitive commercial system. If net profit is accepted as the major stimulus of business, the question naturally arises as to why such a large percentage of retail stores actually show a net loss on their merchandising activities. Of 1,777 stores of various types reporting to the Harvard Bureau of Business Research, 471, or 27 per cent, sustained a net loss as a result of their 1923 operations. It is well recognized that the distribution of commodities at a loss, except during temporary periods of general depression, constitutes economic waste which cannot be justified either from an economic point of view or as a service to the customer, as this loss must eventually be paid for by the consumer.

The first step in the elimination of uneconomic competition among retail merchants is the general adoption of a standard accounting procedure, so that a merchant will definitely know when he is operating at a loss. The method of determining profit is the same, whether the whole store is considered as a unit, or whether it is subdivided into several departments, and profits allocated to each subdivision. In either case, it is the difference between sales and cost of sales, including not only the cost of merchandise sold but the cost of selling. The expenses of a retail store are as much a cost of sales as the original cost of the merchandise, and no profit can be realized on an article except it be sold for more than its original cost to the store plus the cost of selling. A number of stores, work-

ing through the Controllers' Congress of the National Retail Dry Goods Association, have drawn up a standard operating statement which clearly defines the treatment of the different items that affect the net profit figure. The Harvard Bureau of Business Research has facilitated the adoption of this standard procedure by using it as a basis for collecting, through questionnaires, the expense of operation of different types of stores. With the adoption of a standard operating statement, it is possible for stores to make accurate comparisons of gross margin, expense, and net profit percentages.

The Operating Statement.

The function of an operating statement is to show the relation between total income and expenditures for a period. The cost of merchandise on hand at the beginning of a period, plus the purchases, represents the total amount handled. This total, minus the merchandise at cost which is on hand at the close of the period, equals the cost of merchandise sold, which, subtracted from net sales, gives the gross margin. Operating costs are then subtracted, giving net profit. The following is a simple explanation of the items appearing on the operating statement shown below:

OPERATING STATEMENT

Gross sales				$12,400	
Returns and allowances to customers				400	
Net sales					$12,000
Net inventory of merchandise at beginning of year	$4,000				
Net purchases of merchandise	9,000				
Inward freight, express, and cartage	300				
Gross cost of merchandise handled		$13,300			
Net inventory of merchandise at end of year		3,800			
Gross cost of merchandise sold			$9,500		
Cash discounts received on purchases of merchandise			200		
Net cost of merchandise sold				$ 9,300	
Alteration costs				100	
Net cost of sales					$ 9,400
Gross margin					2,600
Total expense					2,000
Net profit					$ 600

Gross sales.—The first item appearing on an operating statement is gross sales, which includes the total of all sales of merchandise purchased for resale or manufactured for sale. Most stores include in this item charges for alteration and money received for special services, because the expenses of performing these services must be paid out of sales. The receipts from customers' restaurants should be included also in gross sales, unless the restaurant is operated as a separate unit. Discounts to employees or customers, and all amounts collected from customers for excise and luxury taxes, are excluded from the gross sales figure. This item represents the maximum income which the store should receive if there were no returns or allowances.

Net sales.—The total amount of merchandise returned by customers and allowances granted to customers is subtracted from gross sales to get net sales. This figure represents the net amount received by the store out of which all items of cost and expense must be paid. The net sales figure is taken as 100 per cent, and all percentages, except discounts on purchases, are based upon it. This practice has been generally adopted, because it makes possible percentage comparisons between different stores and within each individual store. Since 100 per cent is used as a basis for the total net sales which a store receives as a result of its merchandising activities, all percentages of expense may be subtracted from 100, giving a figure which represents the percentage of net profit. Most retailers, also, have adopted the practice of figuring the mark-up percentage on the retail price rather than on the cost price; for example, if an article is bought for 75 cents and marked to sell at $1.00, the mark-up is 25 cents or 25 per cent of the retail price. Assuming that the total expense is 20 per cent, the net profit is 5 per cent. If, however, the mark-up were figured on 75 cents (the cost) the percentage would be 33⅓. It would be impossible, of course, to subtract the 20 per cent expenses from 33⅓ per cent and get a net profit figure, inasmuch as the percentage of expenses is figured on the retail price, whereas the mark-up percentage of 33⅓ is based on the cost price. Since the cost of merchandise and all items of expense must be paid out of money received from sales, the net sales figure is used as a base of 100 per cent.

Net inventory.—The inventory of merchandise on hand at the beginning of a period is the same as the closing inventory of the preceding period. It is the gross inventory, less any allowance for cash discounts actually taken, and less whatever allowance is made for depreciation of merchandise. The common practice is to take inventory at cost, or at market price, whichever is lower, or to take it at the retail price and then reduce it to cost as described under the retail method of inventory. A clear distinction should be made between a book inventory, the amount of merchandise that should be on hand, and a physical inventory, determined by an actual count.

Net purchases.—This item includes all merchandise purchased for resale, less trade discounts, which are an integral part of the purchase price, and less returns and allowances received from vendors. Duties, insurance, and other charges on imported purchases are a part of the cost of such merchandise and are charged to purchases. Merchandise obtained from the store's own manufacturing department should be charged to purchases at cost of material plus cost of manufacturing. Cash discounts which are conditional upon the date of settlement should be included in net purchases.

Inward freight, express, and cartage.—All charges for transportation of merchandise from vendor to store and warehouse should be included under this heading. These are included in the cost of merchandise, rather than expense of operation, so that stores located in different sections of the country may compare expense percentages. From a merchandising point of view, the delivered cost of goods, or the cost at the store, should be used as a basis for figuring a mark-up sufficient to cover costs of selling. One of the factors which the vendor must consider in determining the selling price of merchandise is that of transportation charges. If these are paid by the vendor they must necessarily be included in his selling price. Likewise, if they are paid by the retail store, they should be added to the purchase price in order to get the transportation cost of merchandise. The significance of this problem is brought out more clearly in particular types of merchandise, such as toys, and merchandise which may be shipped "knocked down" and assembled at the store, or shipped "set up." In the first case, the vendor's price and the transportation costs are less, but there is an increased

cost of assembling or setting up the merchandise. As a general rule, a store includes in its cost of merchandise all charges which directly influence the vendor's price. The gross cost of merchandise handled is the sum of net inventory at the beginning of the period, net purchase of merchandise, and the incoming freight, express, and cartage.

Inventory at end of period.—This is the total merchandise on hand taken at cost or market, whichever is lower. Under the cost inventory method, the general practice is to use a code system and show merchandise at billed cost. At the end of the period the inventory consists of: (*a*) Merchandise on hand[1] at (1) "cost," or (2) "cost or market," whichever is lower, according to the method used by the merchant. Material on hand in manufacturing departments should be included. (*b*) Average rate of freight, express, and cartage inward for the period, whenever the figure is obtainable, applied to (*a*). (*c*) Manufacturing payroll and material involved in work in process and unfinished jobs which have not been transferred from a manufacturing to a selling department.

Under the retail method the inventory at the end of the period should consist of: (*a*) The cost equivalent of the retail value of the merchandise on hand. (*b*) Materials on hand in manufacturing departments. (*c*) Manufacturing payroll and materials involved in work in process and unfinished jobs which have not been transferred from a manufacturing to a selling department.[2]

Gross cost of merchandise sold.—The total inventory at the beginning of the period plus purchases, less the inventory

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[1] The total merchandise on hand, under the cost method, is obtained by listing the cost prices appearing on the price tags of the merchandise in stock. Adjustments should be made for the average rate of discounts taken.

[2] In arriving at any average purchase mark-up for a department under the retail method of inventory, it is inadvisable to include materials and payroll of manufacturing departments, because there is a fundamental difference between charges to purchases for this department and those for selling departments. Merchandise purchased for the selling department is entered at both cost and retail in the stock records and a retail price attached to the merchandise. There is thus established a definite relationship between cost and retail at inventory time. When payroll and materials are charged to purchases in a manufacturing department, it is usually impossible to determine the retail price, consequently no accurate purchase mark-up can be obtained in this department. For this reason more accurate results are obtainable by treating payroll and materials separately.

at the end of the period, is the gross cost of merchandise sold. The net cost of merchandise is found by subtracting the discount earned on merchandise purchased from the gross cost of merchandise sold. Some stores treat discount earned on purchases of merchandise as a reduction in the cost of these purchases while others consider it as "other income," adding it to the net operating profit. As far as the store as a whole is concerned, it makes no difference which procedure is followed, as the final net profit or loss figure is the same in either case. If an article, listed at 80 cents with 10 per cent off, is charged to the department at the gross cost of 80 cents and sold for $1.00, the gross margin is 20 cents or 20 per cent. If, however, it is charged at 10 per cent off, or 72 cents, and sold for $1.00, the gross margin is 28 cents or 28 per cent. Assuming that the total expenses of the store are 22 per cent, the operating statement in the first case would show a loss of 2 cents, but the discount earned is 8 cents, so that the net profit actually would be 6 cents.

There are two general classes of discounts, one representing a customary over-charge, which is stated in terms of a percentage and added by the vendor to the actual cost of the merchandise. If the retailer fails to take this discount he is simply paying so much more than actual cost; in other words, he is penalized for not taking the discount rather than gaining by taking it. The other class of discount is a concession or reduction from the list price, because of large purchasing power or a reasonable reward for prompt payment or efficient use of capital. From an accounting point of view, the weight of opinion is that merchandise should be charged at actual, rather than at billed cost.

Alteration costs.—The total merchandise costs are found by adding to the net cost of merchandise sold the costs of alteration. There is a decided diversity of opinion as to what part of the alteration costs should be charged to selling expense and what part to cost of merchandise. In some stores all alteration charges are included in selling expense. It is held by these stores that the adjustment of merchandise to suit the particular desires of individual customers is a selling expense the same as the delivery of merchandise. On the other hand, some stores include all alteration expenses in the cost of merchandise, because they feel that a buyer should

purchase to suit his clientele and that failure to do so should increase his cost of merchandise. The Controllers' Congress recommends that materials, wages, and other expenses of the alteration rooms be added to the net cost of merchandise sold. The sum of these items constitutes an additional cost of merchandise, since a sale in which alterations are involved is not complete until they are finished and accepted by the purchaser.

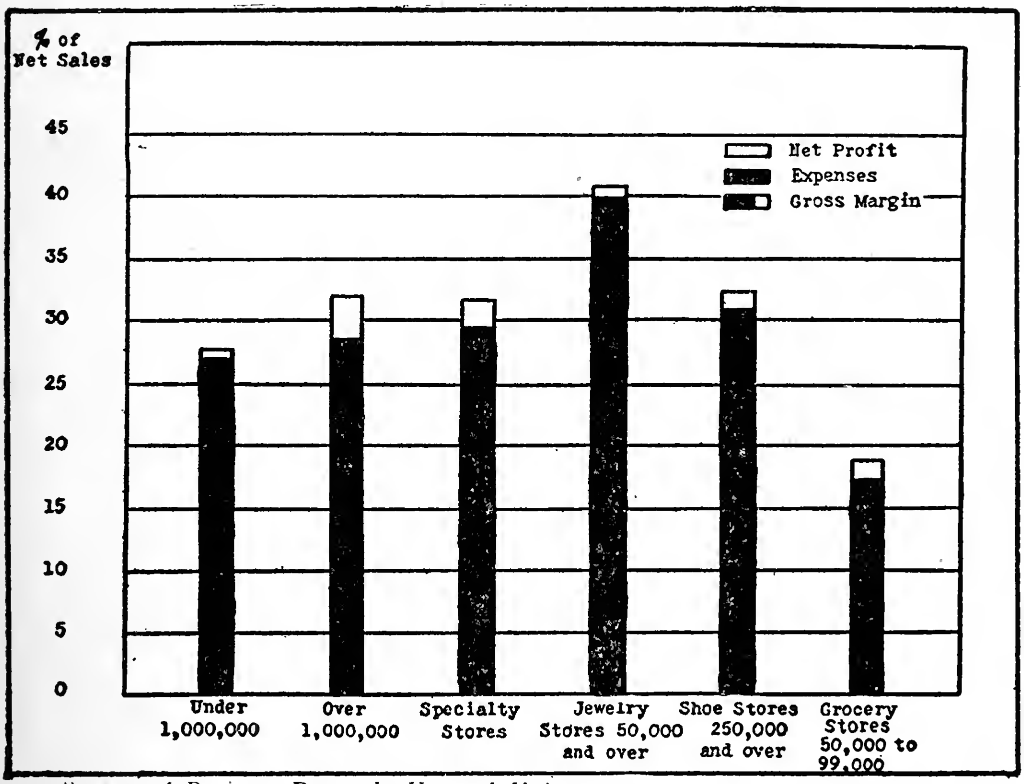
In so far as the position of alteration costs on the operating statement is concerned, there is a distinction between the cost which they represent and the other additions to merchandise cost. Freight, express, and cartage inward represent an additional cost incurred in movement of merchandise inward, and placing it in stock, while the costs represented by alteration do not originate until the merchandise begins to move outward. In some stores a charge is made for alterations, but in most cases these charges do not cover the actual cost of operating the alteration room. The most logical procedure seems to be to charge as an additional cost of merchandise all work done before it reaches the selling floor, and to charge to selling expense all charges for work needed to be done to fit the merchandise to individual customers.

Gross margin.—The total cost of merchandise sold, subtracted from net sales, gives gross margin. Stores have adopted the term "gross margin" in place of gross profit, because it is felt that the word "profit" conveys the wrong impression to those unfamiliar with retail-store operation. Cost of sales includes not only the cost of merchandise, but operating expense, so that the term "profit" should not be used except to refer to the difference between sales and cost of sales, which is net profit. It can readily be seen that the gross margin of a business depends upon the mark-up which it is able to maintain throughout a period. In order to find gross margin, it is necessary to know the inventory at the beginning of the period, purchases, inventory at the end of the period, and net sales. A misstatement in any of these figures will directly affect the gross margin figure. Mark-downs and inventory shrinkages decrease the stock, and thus tend to increase the difference between the original purchase mark-up and the maintained mark-up, or gross margin.

Due to the difference in merchandising policies, local conditions, types of merchandise handled, service rendered, and

efficiency of operation, the percentages of gross margin vary widely between different types of retail stores. So far there has been no analysis of sufficient detail to determine what the retailer's percentage for these items should be. At the present time percentage figures are available for a representative group of all types of retail stores, but these percentages show such a wide range that accurate conclusions cannot be drawn.

Table 3 and Figure 4 show the gross margin percentage in



Bureau of Business Research, Harvard University

Fig. 4—Operating Expenses, Net Profit, and Gross Margin for 1922.

representative groups of stores. As indicated by this table, a department store under $1,000,000 had a common figure, in 1922, of 27.8 per cent of net sales as compared with 32 per cent for stores with sales over $1,000,000. In the former group the range was from 17 per cent to 38.9 per cent, as compared with 25 per cent to 38 per cent in the latter group. The gross margin in these two groups of stores in 1923 was 28.2 per cent and 32 per cent respectively. The specialty stores group had a common figure of 31.9 per cent in 1922 and 32.9 per cent in 1923, which was slightly higher than that of department stores of the larger size. Jewelry stores in 1920 had

a common figure of 39.1 per cent as compared with 27.2 per cent for shoe stores, 34 per cent for drug stores, and 19 per cent for general merchandise stores. The ranges in gross margin percentage in these groups of stores for 1920 were 17.4 to 56.1 per cent, 20 to 40 per cent, 20.6 to 30.1 per cent, and 9.8 to 31.5 per cent, respectively.

TABLE 3

PERCENTAGE OF OPERATING EXPENSE, GROSS MARGIN, AND NET PROFIT IN DIFFERENT TYPES OF STORES *

Net Sales = 100 Per Cent.

Type of Store	*Gross Margin*	*Operating Expense*	*Net Profit*	*Year*
Department store				
under $1,000,000	27.8	27.1	.7	1922
under $1,000,000	28.2	26.3	1.9	1923
over $1,000,000	32.0	28.6	3.4	1922
over $1,000,000	32.0	28.4	3.6	1923
Specialty store	31.9	29.4	2.5	1922
	32.9	29.6	3.3	1923
Jewelry store	40.1	32.3	7.6	1919
	39.1	32.7	6.4	1920
	36.9	43.5	6.6 (*loss*)	1921
	38.3	36.4	1.9	1923
Shoe store	33.1	24.0	9.0	1919
	27.2	26.0	1.2	1920
	25.9	27.8	1.9 (*loss*)	1921
	28.1	28.1	0.0	1922
	29.1	27.4	1.7	1923
Grocery store	19.1	17.3	1.8	1923
Drug store	34.0	27.6	6.3	1919
Hardware store	27.1	21.0	5.8	1919
General merchandise store...	19.0	15.5	3.4	1918

* Bulletins of the Bureau of Business Research, Harvard University.

From these figures it would seem that out of every dollar of sales the merchant gets an average of approximately 30 cents to cover operating costs and net profit. It can readily be seen, however, that the common figure for gross margin does not in any way indicate the relation which exists between sales and cost of sales in any particular store or line of merchandise within a store. Furthermore, the fact that larger department stores show a higher mark-up than the small stores does not necessarily indicate that the prices are higher in the former group. This wider margin may be, and in most cases

is, the result of lower costs for merchandise because of quantity purchases. Similarly, the gross margin in the general merchandise store may be small and yet the prices be as high as those of the larger stores.

Expenses.—The expenses of a store include all the costs which are incurred from the time the goods are received until the money for the sale is actually collected from the customer. Expenses may be in the form of actual outlays of money, as the payment of wages to salespeople; or in the form of depreciation of building and equipment, losses from bad debts, interest on owned capital, or rent on owned buildings. Total expense does not include inward freight, express, and cartage, since these items are accounted for in the merchandise statement as part of the cost of merchandise; neither is depreciation in merchandise included as an expense, this item being absorbed in the merchandise statement by the entry of a net figure for inventory of merchandise at the end of the period. It can readily be seen that if total expenses are to be comparable between stores, the method of arriving at them must be uniform throughout.

The total expense percentages for different groups of stores, as compiled by the Harvard Bureau of Business Research, are shown in Table 3. These percentages show about the same variation as the gross margin. Department stores with sales volume under $1,000,000 had a common figure of 27.1 per cent for total expense in 1922. In this group of 340 stores, 20 reported total expenses as less than 20 per cent, and 23 as more than 35 per cent of net sales. Among the lowest figures reported for total expense was one of 18.7 per cent of net sales for a department store with sales of approximately $219,000, in 1922. In this store, the gross margin was 29.5 per cent and the net profit 10.8 per cent. Of the 151 department stores reporting to the Harvard Bureau of Business Research with sales over $1,000,000 in 1922, there was a variation in total expenses from 22 per cent to 39 per cent, with a common figure of 28.6 per cent. Specialty stores reported total expense figures varying from 27.5 per cent to above 33 per cent of net sales, with a common figure of 29.4 in 1922 and 29.6 in 1923. The expense in jewelry stores, shoe stores, and drug stores in 1919 was 32.3 per cent, 24 per cent, and 27.6 per cent respectively. In the same year the

range in expense percentages was 17 to 56 per cent in jewelry stores, 13.6 to 25.6 per cent in shoe stores, and 17.9 to 42.9 per cent in drug stores. The common expense percentage in general merchandise stores for 1919 was 15.5 per cent with a range from 10 to 29.5 per cent.

As the figures in the foregoing discussion indicate, a typical department store with net sales amounting to $5,000,000 in 1922 expended $3,400,000 for merchandise and $1,430,000 for operating costs, and made a net profit of $170,000. A typical department store with net sales amounting to $500,000 for the same year expended $360,500 for merchandise and $134,500 for costs of operation, and made a net profit of $5,000. A typical jewelry store with net sales of $100,000 in 1922 had operating expenses of $40,000, and made a net profit of only $700; a shoe store with net sales of $100,000 had operating expenses of $28,500, and made a net profit of $1,100; and a typical grocery store with net sales of $100,-000 had expenses amounting to $17,700, and made a net profit of $2,300.

Net profit.—Net profit is the amount that remains after deducting total expenses from gross margin. It is a residual amount over and above all expenses, including salaries of proprietors or partners, rent of owned buildings, and interest on the owner's own capital invested in the business. Net profit is a return for the exercise of special effort and foresight in the management of the business and for the risks incurred. A clear distinction should be made between net profit and net gain. The latter figure includes the interest on owned capital charged as an expense and then credited back to the business. The net profit or loss figure, therefore, represents what the management of the business has earned over and above all expenses, including interest, rent on owned building, and proprietor's salary. This is the only true meaning of net profit, and when used in this sense it furnishes a measure of the real profits of a business, since a business cannot be termed profitable if it does not return its owners more than they could secure by lending their capital and accepting employment from others. If there were a uniform acceptance in the smaller stores of the true meaning of net profit, the result would be a partial elimination of uneconomic competition, since the

owners of business would all be charging to the business its real expense.

Net gain statement.—The following net gain statement is used by the Harvard Bureau of Business Research in collecting comparable figures for department stores:

NET GAIN STATEMENT

Gross margin		
Total expense		———
Net profit (or loss)		
Sundry revenue (net)		
Interest and rentals earned	———	———
Total net gain (or loss)		
Provision for income and excess profits taxes		
Dividends, sharings, or withdrawals	———	———
Surplus (or deficit) for the year		

Income from sources other than merchandising is added to net profit to give total net gain or loss. In some lines of business, such as jewelry and shoes, this may include operating repair departments which return a profit in addition to that obtained from regular merchandising operations. Profit or loss in manufacturing departments is shown under this heading. Incidental losses not a part of merchandise operations are deducted before the entry is made for this item. The interest on money invested in the business, exclusive of real estate, and rent on owned real estate, including store building, warehouse, stable, and garage, is added to net profit to get net gain. For instance, if the owner of a business has $10,000 invested, he should charge his business with a normal amount of interest as an expense of operation in order to arrive at net operating profit. This same amount of interest is then added to net profit in arriving at net gain. Federal income taxes are a deduction from net gain, not as an expense, but as a sharing of profits with the government. Dividends declared and partner's sharings awarded (not including salary) constitute a distribution of net gain and should be deducted in arriving at the surplus for the year.

Inasmuch as net profit is the difference between gross margin and total operating expenses, its variation is the result of the variation in the other two percentages. In Table 3, the common percentage for net profit is shown for a representative group of stores. Of the 340 department stores with sales

under $1,000,000, one hundred thirty-eight sustained a net loss in 1922; in 23 cases this loss amounted to more than 6 per cent of net sales. On the other hand, 18 stores in this group reported net profits amounting to more than 6 per cent of net sales. In the 151 department stores with sales over $1,000,000, the range was from 7 per cent net loss to several net profit figures above 8 per cent; twenty-five stores in this group sustained a net loss as a result of their 1922 operation. Of the 31 specialty stores, 7 sustained a net loss in 1922, and at the other extreme several net profits of more than 6 per cent of the net sales were reported. Drug stores varied from a loss of 6 per cent to a profit of 19.4 per cent; hardware stores from a loss of 4.9 per cent to a profit of 17.3 per cent; and general merchandise stores from a loss of 10 per cent to a profit of 17.7 per cent.

From such information as is available at the present time, the chain stores as a group show a higher net profit on sales than any other class of store. A comparison of net profits on

TABLE 4

NET PROFITS IN DIFFERENT TYPES OF STORES*

Net Sales = 100 Per Cent.

Name of Company	*1923 †* *Per Cent*
Department Stores	
Gimbel Brothers, Inc.	7.26
May Department Stores Co.	7.34
R. H. Macy & Co., Inc.	6.51
National Department Stores, Inc.	5.94
J. C. Penney Company	7.22
Variety and Other Chain-store Groups	
F. & W. Grand	10.72
S. S. Kresge Co.	11.6
S. H. Kress Co.	10.2
McCrory Stores Corp.	7.82
F. W. Woolworth Co.	10.70
G. R. Kinney (shoes)	6.02
United Drug Co.	6.19
American Stores Co. (grocery)	4.25
Mail-order Firms	
Montgomery Ward & Co.	6.30
National Cloak & Suit Co.	4.12
Sears, Roebuck & Co.	5.80

* Net profit is arrived at after all deductions for taxes and interest on bonded indebtedness.

† *Women's Wear*, April 26, 1924.

sales for 1923 for some of the leading department stores, chain stores, and mail-order houses, as shown in Table 4, indicates that the net-profit figure for chain stores is decidedly above the same figures for the other two groups. The advantages accruing to large-scale buying, standardization in equipment, and efficiency in management and operation account for the larger net profit of the chain store. Another factor contributing to the lower cost of operation is the fact that chain stores do not render the costly service which is given by department stores.

Relation of expense to size of store.—It is the opinion of many retailers and writers, that an increase in the volume of business of individual stores will result in a decrease in the expense percentages and a consequent economy of operation. This conclusion is based upon the theory that mass distribution, like mass production, results in decreased costs. It seems, however, that retailing is different from most other businesses in this respect. For the 340 firms which reported to the Harvard Bureau of Business Research in 1922 with sales volume less than $1,000,000, the common figure for total expense was 27.1 per cent of net sales, whereas the common figure for total expense in 151 stores of more than $1,000,000 sales was 28.6 per cent of net sales, or an increase of 1.5 per cent over the smaller stores. A further division, according to size, shows that the total expense for stores with sales under $250,000 was 26.4 per cent, and for those with sales over $10,000,000, 29.5 per cent. Between these two groups there was a general increase in the percentage of expenses with the size of the store as shown in Table 5 below. The results in the 1921 survey were about the same. In 1923 the total expense for stores under $1,000,000 was 26.3 per cent (a decrease of .8 per cent over 1922), and for stores over $1,000,000 the total expense was 28.4 per cent (a decrease of .2 per cent over the 1922 figure). In other classes of stores, similar variations according to the volume of sales have been shown. In retail shoe stores there is a decrease in expense percentages from the small- to the medium-size stores, then a steady increase in expense percentage as the sales volume increases. The same is true in the retail clothing stores and grocery stores.

TABLE 5

DEPARTMENT-STORE EXPENSE *

Expressed in Percentage of Sales.

Volume of Sales	*1921*	*1922*	*1923*
$10,000,000 and over		29.5	27.8
4,000,000 to $10,000,000		29.0	28.2
2,500,000 and over	28.5		
1,000,000 to $4,000,000		28.4	28.5
1,000,000 to 2,000,000	28.7		
500,000 to 999,000	28.3	28.3	27.6
250,000 to 499,000	27.6	27.5	26.6
250,000 or less	26.6	26.4	25.4

* Bureau of Business Research, Harvard University, *Bulletin Nos.* 33, 37, *and* 44.

TABLE 5-A

SHOE-STORE EXPENSE *

Expressed in Percentage of Sales.

Volume of Sales	*1922*	*1923*
$250,000 and over	31.2	32.0
100,000 to $250,000	28.5	27.5
50,000 to 100,000	27.3	26.7
30,000 to 50,000	27.0	25.5
30,000 or less	28.3	27.8

* Bureau of Business Research, Harvard University, *Bulletins, Nos.* 36 *and* 43.

At the present time, there are not sufficient data available to draw a definite conclusion regarding the cause of this increase in operating costs with sales volume. There are, however, certain outstanding reasons why the ratio would not materially decrease. As a general rule, the larger stores give more extensive service than the smaller stores, which accounts in part for the increased costs. Sales per salesperson seem to remain about constant in the different-sized stores. The expense percentage for executive salaries tends to decrease as sales increase, but this decrease is more than counter-balanced by an increase in buying salaries. Again, the percentage for advertising expense tends to increase with volume of sales, as do rentals and supplies. It is reasonable, therefore, to expect that the ratio of total expense to sales will at least remain constant as the sales volume increases. Because of this fact, it does not seem that the costs of distribution will be mater-

ially reduced by a mere increase in the volume of sales of individual units. Furthermore, it does not seem reasonable to suppose that mergers and combinations of department stores into chains will materially reduce the cost of operation.

The chief significance of a study of comparative expense percentages in different-sized stores is that a mere increase in volume does not necessarily result in economy of operation. On the other hand, there are found in every type of store outstanding examples of a large volume of sales and relatively low operating costs. For example, one store, reporting to the Harvard Bureau of Business Research with net sales of approximately $3,000,000 and a gross margin of 27.5 per cent of net sales, had a total expense of 22.9 per cent and secured a net profit of 4.6 per cent. In most cases, however, the large volume in sales does not account for the low-expense figures, but rather both are the result of efficient operation, and exceptional management. It cannot be concluded, however, that, because the larger stores have higher operating expenses, their prices for comparable merchandise are necessarily higher. The savings through lower costs of merchandise because of larger purchasing power make possible a wider gross margin without a corresponding increase in the retail price.

The balance sheet.—The balance sheet represents the financial condition of a business at a fixed time. It differs from an operating statement, in that it is a cross-sectional view of a business, whereas an operating statement gives a longitudinal view over a given period. The former denotes position, the latter progress. The balance sheet consists of a listing of assets, appearing on the left-hand side of the sheet, and liabilities, appearing on the right-hand side. Figure 4A shows the form of financial statement used by the Harvard Bureau of Business Research in collecting data from department stores. The major divisions appearing on this form have been generally adopted by retail stores so that comparisons are made possible.

Assets.—In general the assets represent the property and rights which can be used to offset the liabilities of a business, arranged according to their liquidity. The assets of a retail store under the standard form are divided into current, other, deferred, and permanent. Current assets consist of cash on

***Date*....................**

Assets	
Current	
Cash on hand and in bank	....
Notes receivable (customers)	....
Accounts receivable (customers)	....
Net inventory of merchandise	
United States securities...	....
	....
	....
Other Assets	
Accrued interest	....
Other accrued items.......	....
Investments	....
	....
	....
	....
Deferred Charges	
Prepayments	....
Net inventory of supplies..	....
	....
Permanent	
Real estate	....
Leasehold	....
Net inventory of equipment	....
	....

Liabilities	
Current	
Notes payable	....
Accounts payable	....
Accrued items	....
	....
	....
	....
	....
Other Liabilities	
	....
Real estate mortgage notes	....
	....
	....
	....
	....
Reserves	
For Federal and State income taxes	....
For contingencies	....
	....
	....
Capital	
Preferred—issued	....
Common—issued	....
	....
Profit and Loss—Surplus	
Undivided surplus	....
Undivided profits	....
	....
	....

Fig. 4A—Financial Statement.

hand or in the bank, and of those items which may be readily converted into cash for the purpose of meeting current obligations, such as notes receivable, accounts receivable, net inventory of merchandise, and United States securities. Accounts receivable include accounts of charge customers, and all other amounts owing to the business upon accounts with solvent trade debtors. Net inventory of merchandise is the cost or market value, whichever is lower, of merchandise on hand.

Other assets include all personal and impersonal accounts not included elsewhere. In the larger stores this account may include such items as securities of other corporations, invest-

ments, and sundry notes and accounts receivable, other than those arising in the ordinary transactions of business, and the accrued interest on these assets. Deferred charges consist of expenses paid in advance and chargeable to subsequent periods, such as prepayments of insurance, taxes, rent, supplies, and organization expenses. Permanent assets represent the cost of all interests in land, buildings, leaseholds, and equipment, such as machinery and fixtures with the proper provision for their depreciation.

Some retail stores carry on their balance sheets an account for goodwill, patents, and trade-marks. It is well recognized that, although intangible, a reputable store, over a period of years, actually produces an element of value by maintaining satisfactory service and pleasant experience on the part of customers. It invests a large amount of money in advertising and adjustment of complaints in order to break down the sales resistance of its clientele. As a growing concern its advertising is more effective dollar for dollar than a new concern just entering the locality. Because the value of goodwill is so problematical, the usual practice in accounting is to refrain from showing it as an asset upon the books unless it has been paid for by something given in exchange.

Liabilities.—The major divisions of liabilities appearing on the balance sheet are current, funded indebtedness, reserves, capital stock or investment account, and surplus. Current liabilities consist of notes and accounts payable, and other items accrued in anticipation of payment, such as taxes, payroll, interest, rent, advertising, traveling expenses, and other obligations for services which have been rendered previous to the date of the balance sheet but unpaid on that date. Funded indebtedness includes real-estate mortgages, notes, and long-term bonds. Reserves represent the amount of surplus set aside as a reserve fund to meet federal income taxes, contingencies, and losses not otherwise provided for. Capital stock includes the amount of stock authorized, having a par value, less the par value of redeemed or unissued stock. If stock of no par value has been issued, this account represents the cash, or its equivalent, received in payment of stock issued. In the case of a sole ownership or partnership of a business not incorporated, the capital account represents the net investment of the sole owner or partners. The profit and loss

account represents the amount of paid-in surplus and the undistributed earnings of the business at the date of the balance sheet.

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Problems.

1. A department shows the following figures for the year 1923:

Returns and allowances to customers..................	$ 10,602.06
Purchases of merchandise at billed cost................	190,421.45
Merchandise returned to wholesalers..................	18,291.00
Net inventory of merchandise, December 31, 1921......	20,251.17
Inward freight, express, and cartage..................	1,333.44
Gross sales	267,438.04
Inventory of merchandise, December 31, 1922...........	19,093.87
Cash discounts received on purchases of merchandise....	5,553.82
Alteration costs (charge to cost of merchandise)........	4,619.04
Total expense for department..........................	59,780.00

(*a*) What was the percentage of gross margin? Net profit?

(*b*) What was the percentage of discount taken?

(*c*) What is the purpose of an operating statement? How does it differ from a balance sheet?

2. The Hale department store recently had an anniversary sale lasting one week, during which each department featured some merchandise with a mark-up of only 10 per cent. This sale seemed to be very successful, but the merchandise manager is not certain whether the

store actually showed a profit during the week. The total sales for the week were about 30 per cent above normal and an analysis showed that about 75 per cent were in regular merchandise and 25 per cent in sale merchandise. The average normal maintained mark-up for the store as a whole is about 31 per cent for this period (not including the merchandise purchased for special sale) and the normal expense, 27 per cent.

Assuming that the total expenses were decreased by 3 per cent, because of increased business as a result of the sale, did the store actually make a profit for the week?

3. The buyer of ladies' ready-to-wear in the Hood department store got an average discount of 8 per cent on purchases in 1923, but the stock was charged to his department at list price. His total sales were $120,000 and his gross margin 32 per cent. The total expenses charged to his department were $40,000. The stock at the beginning and at the end of the period was just the same.

(*a*) What was his percentage of net profit for 1923?

(*b*) Should discount be subtracted to get cost of merchandise or should it be treated as other income?

4. Mr. Hill operates a general merchandise store which, in 1923, had a net sales volume of $630,000. Mr. Hill has been in the habit of figuring mark-up on cost and expense percentages on gross sales instead of on net sales. During 1923, his maintained mark-up was 48 per cent and his total expenses were 28 per cent. He found that 10 per cent of his gross sales had been returned by customers.

(*a*) What was his per cent of net profit for the year?

(*b*) Why should net sales equal 100 per cent as a basis in figuring percentages?

(*c*) Reduce all of the above percentages to a percentage of net sales.

5. Some retailers are of the opinion that mass distribution will materially decrease the cost of retailing. They point to the economical mass production, showing that it materially lowers the unit costs. The Ford plant is cited as an example of the trend in production.

(*a*) What is the relation between volume of sales and retail expenses?

(*b*) Are there any particular reasons why large-scale retailing should not result in the same economies as large-scale production?

6. The buyer of housefurnishings in the Hale department store recently made an investigation in order to determine why his department was showing a loss on several of the lines carried. This store

belongs to an association which exchanges expense figures on cost of operation. The buyer found that his total selling cost was lower than any other store in the association. However, he found that his initial mark-up was smaller, although his retail prices were about the same for the different lines. Further investigation showed that the lower mark-up was due to his method of purchasing unit-packed merchandise. For example, wash-boilers were purchased packed separately, and were sold from sample and delivered to the customer without being unpacked. The buyer was of the opinion that the lower cost of re-crating or packing for delivery would more than offset the higher merchandise cost due to individual packing.

Another problem of his department was the increased number of returns by customers due to imperfect and damaged merchandise. The buyer does not wish to discontinue his present practice until he has made further comparisons with other stores of the association.

How can he get his mark-up and selling cost percentage on a basis comparable with the other stores?

7. The Hood department store, located in a large city in the East, does an annual business of about $10,000,000. It is the policy of this store to make all alterations without charge to the customer. The cost of alteration is charged to the different departments on the basis of total sales. At one of the executive meetings the problem of charging for alterations was discussed, and several different views were expressed. The merchandise manager of drugs objected to the policy of free alterations, because he thought it robbed him of his due share of the profits. The general manager thought that the cost of alteration should be charged as a selling expense directly to the department concerned. He maintained that the goods were brought into the store in excellent condition, but that the customer must be assured a good fit or she would not buy; therefore, the cost of alteration was a selling expense.

The controller suggested that the cost of alteration should be charged as a part of the cost of merchandise and that a certain percentage be added to the mark-up in order to determine the retail price. He felt that it was the buyer's duty to buy merchandise in the right styles and sizes to suit his clientele, and that failure to do so should be reflected in the cost of merchandise rather than in selling expense.

What policy should this store adopt?

8. Why should inward freight, express, and cartage be included in the cost of merchandise?

9. Gross margin is used by a large number of stores instead of gross profit. Why have stores made this change? Is there any particular advantage in such a policy?

10. The following figures were found on the books of the Ranson department store for the year 1924:

Accounts receivable (customers)	$ 48,095.48
Real estate	111,204.27
Leasehold	33,889.36
Net inventory of supplies	642.79
Investments	55,251.75
Accounts payable (mdse.)	110,211.13
Accounts payable (sundry)	111.10
Common stock—issued	112,300.00
Undivided surplus and profits	118,004.46
Net inventory of equipment	17,186.87
Prepayments	4,103.71
Other assets	15,222.74
Accrued items of expense	41,158.24
Cash on hand and in bank	5,660.34
Notes receivable	900.00
Net inventory of merchandise	219,627.62
U. S. securities	5,000.00
Notes payable	135,000.00

Arrange these figures in the standard form of balance sheet.

Chapter IV

CLASSIFICATION AND DISTRIBUTION OF EXPENSES

Classification.

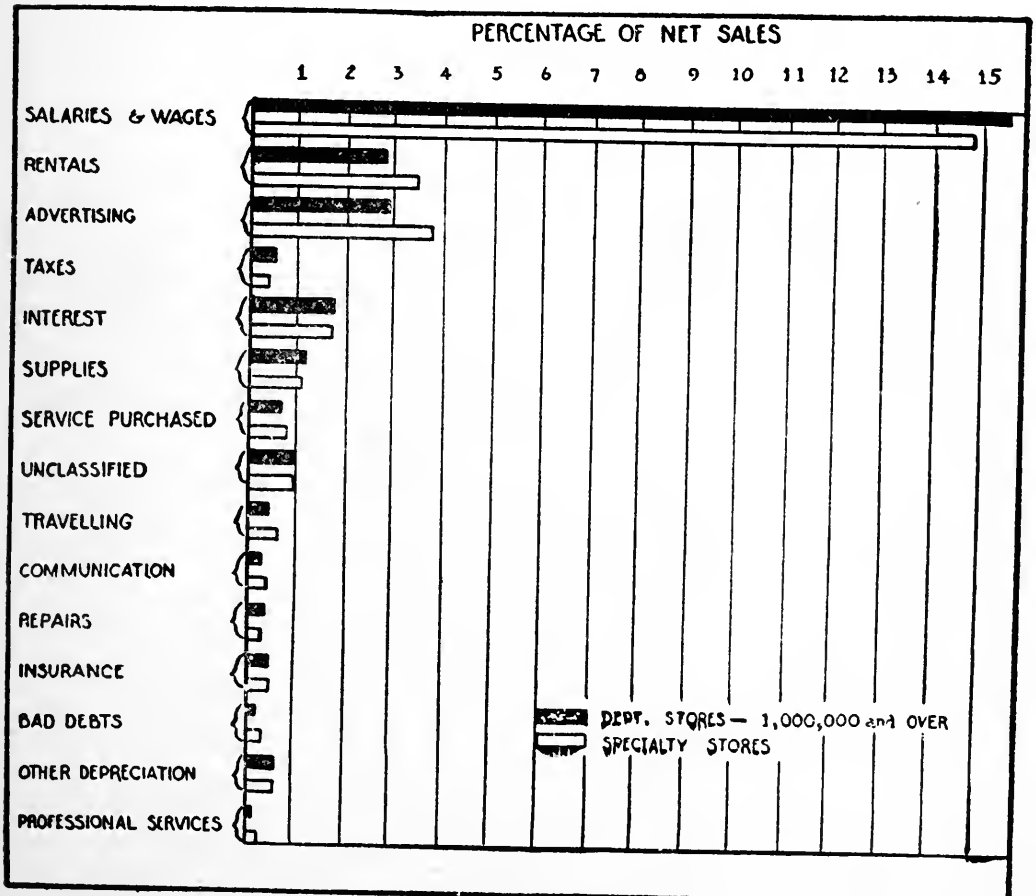
In order to make a more detailed analysis of expense percentages in individual stores, it is necessary to classify expenses according to the items for which they are incurred. The number of these classifications depends upon the size and the division of functions within the store. For the purpose of detailed comparison between different institutions, the Controllers' Congress of the National Retail Dry Goods Association has drawn up a standard expense classification, Figure 5, which is used by the Harvard Bureau of Business Research in its studies of operating expenses in department stores and has been adopted generally throughout the country. Since operating conditions vary widely, the system has been outlined in such a way as to be flexible and easily adjusted either to small or to large stores. For the small store the purpose is to treat expenses as pertaining to the business as a whole, whereas in the large store it is applicable to the expenses of each individual department.

The fourteen classifications appearing on the left of the expense statement below are called the natural divisions of expense, because they represent the simplest elements. When money is paid as a cost of doing business it must be for salaries or wages, rent, advertising, or some of the other expenses appearing in this classification. These natural divisions are further classified under five functional groups, according to the particular purpose for which the expenses are incurred. Thus, the salaries and wages of the advertising department would be classified under the vertical column headed publicity, and the horizontal one headed salaries and wages. Similarly the wages of salespeople fall under selling.

	Administrative and General	Occupancy	Publicity	Buying	Selling: General Selling	Selling: Delivery	TOTAL
SALARIES AND WAGES	EXECUTIVE 1.4% OTHER ADMIN. 0.4 OFFICE 1.4	0.9%	0.6%	BUYING 2.2% RECEIVING, MARKING, AND STOCK-ROOM 0.3	DIRECT SELLING 6.0% MANAGEMENT AND ASSISTANTS 0.7 INDIRECT SELLING 1.1	0.6%	15.6%
RENTALS	xxxxxxx	2.6	0.2	0.05	xxxxxxx	0.04	2.9
ADVERTISING	xxxxxxx	xxxxxxxx	2.9	xxxxxxx	xxxxxxx	xxxxxxx	2.9
TAXES	0.4	0.1	xxxxxxxx	0.0	xxxxxxx	0.02	0.5
INTEREST	INTEREST ON CAPITAL-BORROWED 0.4 INTEREST ON CAPITAL-OWNED 1.7	0.0 0.0	xxxxxxxx	xxxxxxx	xxxxxxx	0.0 0.0	2.1
SUPPLIES	0.1	0.2	0.1	0.04	0.6	0.2	1.2
SERVICE PURCHASED (HEAT, LIGHT, POWER, DELIVERY)	xxxxxxx	0.5	xxxxxxxx	xxxxxxx	xxxxxxx	0.1	0.6
UNCLASSIFIED	0.4	0.2	0.05	0.1	0.2	0.1	1.1
TRAVELLING	0.03	0.0	0.0	0.4	0.01	0.0	0.4
COMMUNICATION	0.2	0.0	0.01	0.03	0.0	0.0	0.2
REPAIRS	0.01	0.1	0.0	xxxxxxx	xxxxxxx	0.04	0.2
INSURANCE	0.3	0.05	0.0	0.0	xxxxxxx	0.03	0.4
DEPRECIATION	LOSSES FROM BAD DEBTS 0.2 OTHER DEPRECIATION xxxxxxx	0.5	xxxxxxxx	xxxxxxx	xxxxxxx	0.1	0.8
PROFESSIONAL SERVICES	0.1	0.0	0.0	0.0	xxxxxxx	xxxxxxx	0.1
TOTAL	7.0	5.2	3.7	3.1	TOTAL GENERAL SELLING 8.4	TOTAL DELIVERY 1.2 TOTAL GENERAL SELLING 8.4 TOTAL SELLING 9.6	28.6

Bureau of Business Research, Harvard University.

Fig. 5—Expense Statement.



Bureau of Business Research, Harvard University.

Fig. 6—Operating Expenses in Department Stores over $1,000,000, and in Specialty Stores, in 1923.

Natural expenses.—In the small unit store in which the proprietor performs all the functions of buying and selling, there is no necessity for functional classification, and the fourteen natural divisions exist only in their simplest form. As the business grows, however, the standard system provides an opportunity for a more detailed expense classification. The common figures for expenses in representative groups of stores are shown in Tables 6, 7, and 8. The percentage of net sales for each of the fourteen natural divisions is shown graphically in Figure 6. A simple explanation of natural expenses is given in the following paragraphs.

Salaries and wages.—Under this heading is included all compensation to employees for salaries, wages, commissions, bonuses, P. M.'s,[1] and any other form of remuneration for

TABLE 6

OPERATING EXPENSES IN DEPARTMENT STORES*

Net Sales = 100 Per Cent.

Item	Net Sales Less Than $1,000,000 1922	Net Sales Less Than $1,000,000 1923	Net Sales More Than $1,000,000 1922	Net Sales More Than $1,000,000 1923
Number of stores	340	403	151	163
Salaries and wages	14.9%	14.2%	15.4%	15.4%
Rentals	2.3	2.3	2.9	2.8
Advertising	2.1	2.0	2.9	2.9
Taxes	0.7	0.7	0.5	0.5
Interest	2.6	2.5	2.1	1.8
Supplies	0.6	0.65	1.0	1.2
Service purchased (heat, light, power, delivery)	0.7	0.7	0.6	0.6
Unclassified	1.0	1.0	1.1	1.0
Traveling	0.4	0.35	0.4	0.4
Communication	0.2	0.25	0.2	0.25
Repairs	0.2	0.2	0.2	0.25
Insurance	0.5	0.5	0.4	0.35
Depreciation—				
losses from bad debts	0.3	0.3	0.2	0.2
other depreciation	0.5	0.5	0.6	0.6
Professional services	0.1	0.1	0.1	0.15
Total expense	27.1	26.3	28.6	28.4
Gross margin	27.8	28.2	32.0	32.0
Net profit	0.7	1.9	3.4	3.6

* Bureau of Business Research, Harvard University, *Bulletins Nos. 37, 44.*

[1] A P.M. is a device used by the retailers as a premium to the salesman for selling slow-moving stock. It varies widely, ranging from 5 cents to $1 per sale.

TABLE 7

PERCENTAGE OF OPERATING EXPENSES, GROSS MARGIN, AND NET PROFIT IN SPECIALTY STORES *

Net Sales = 100 Per Cent.

Item	*1922*	*1923*
Number of stores	31	41
Salaries and wages	15.2	14.8
Rentals	3.3	3.4
Advertising	3.4	3.8
Taxes (except on buildings and income)	0.3	0.3
Interest (on capital borrowed and on capital owned)	1.8	1.7
Supplies	1.1	1.1
Service purchased (heat, light, power, delivery)	0.7	0.7
Unclassified	1.0	1.0
Traveling	0.6	0.6
Communication	0.3	0.3
Repairs (except on buildings)	0.3	0.2
Insurance (except on buildings)	0.3	0.45
Depreciation—		
losses from bad debts	0.2	0.3
other depreciation (except on buildings)	0.7	0.7
Professional services	0.2	0.2
Total expense	29.4	29.6
Gross margin	31.9	32.9
Net profit	2.5	3.3

* Bureau of Business Research, Harvard University, *Bulletins Nos. 37, 44.*

TABLE 8

COMMON EXPENSE PERCENTAGES FOR RETAIL TRADES IN 1923 *

Net Sales = 100 Per Cent.

	Grocery	*Shoes*	*Jewelry*
Number of stores	471	499	290
Total salaries and wages	10.6	14.7	17.1
Advertising	.3	2.2	2.8
Rent	1.3	3.5	4.5
Total interest	1.0	2.7	4.6
Total expense	17.3	27.4	36.4
Gross margin	19.1	29.1	38.3
Net profit	1.8	1.7	1.9

* Bureau of Business Research, Harvard University, *Bulletins Nos. 41, 43, 47.*

services. The common figure for this expense in 1923 was 14.2 per cent in department stores under $1,000,000, with a range from below 10 per cent to above 20 per cent. For stores over $1,000,000 the common figure for the same year

was 15.4 per cent, with a range from 11 to above 20 per cent. In shoe stores this expense was 14.9 per cent, in specialty stores 15.2 per cent, and in grocery stores approximately 7 per cent in 1922. According to the best information available salaries and wages comprise from 50 to 55 per cent of the total expenses of the retail store. In the larger stores nearly one-half of the total salary and wage expense is for direct selling.

In department stores with sales under $1,000,000, in 1923 the common figure for this expense was 7 per cent; and for stores over $1,000,000, 5.9 per cent. The wages of the sales force in 1922 for grocery stores were approximately 7 per cent; for hardware stores 6.2 per cent; for drug stores 12 per cent; and for shoe stores with sales over $250,000, 9.6 per cent.

As the figures in Table 6 indicate, a typical department store with net sales amounting to $2,500,000 in 1923 expended $385,000 for salaries and wages. This total included $35,000 for executive salaries; $10,000 for other administrative salaries; $35,000 for office salaries; $22,500 for occupancy salaries and wages (plant operation and caretaking); $10,000 for salaries and wages in the publicity department; $55,000 for salaries of buyers and their assistants; $150,000 for wages of sales force (direct selling); and $60,000 for other selling wages.

Rentals.—Under this item is included all rents paid for the premises occupied. In order to secure proper comparison between the rental figures for a rented building and one that is owned, it is necessary, when the building is owned, to include taxes, repairs, insurance, interest on valuation, and depreciation on the owned building. In 1922, department stores under $1,000,000 had a rental expense of 2.3 per cent, and those over $1,000,000 a rental of 2.9 per cent. Specialty stores had a common figure for rentals of 3.3 per cent in 1922 and 3.4 in 1923. The rent in shoe stores was about 3 per cent in 1921. The amount of rent paid for the use of premises varies directly with the potential shopping traffic in that location. Some stores are able to anticipate an increased shopping traffic and, by taking long leases, materially to increase sales volume without a relative increase in rentals. On the other hand, some stores, hoping to decrease their rental expense,

move away from the shopping centers to locations where rents are lower. It has usually been found true, however, that any savings in rental costs must be spent in advertising to create a shopping traffic, and thus, in the long run, these two expenses tend to reach about the same total.

Advertising.—This item includes all newspaper, periodical and program space, street-car cards, billboards, and other media having direct advertising value. In 1922 the common figure for department stores under $1,000,000 was 2.1 per cent and 2.9 for those over $1,000,000. For specialty stores, the advertising expense was 3.4 per cent for the same year. Advertising expenses in shoe stores varied from 1.6 per cent in stores with net sales less than $30,000 in 1922 to 3.8 per cent in those with sales over $250,000. The common figure for this item of expense in jewelry stores in the same year was 2.6 per cent in stores under $20,000 and 4.3 per cent in stores with sales of more than $50,000.

Taxes.—This item includes all taxes paid on merchandise, money, accounts and store, warehouse and delivery fixtures and equipment. Taxes on real estate should not be included in this item. The common figure for taxes is about .5 per cent, varying from .3 in specialty stores to more than 1 per cent in some jewelry stores.

Interest.—In this item is included the interest on borrowed money and on the net investment in business, except that on real estate, which has been provided for under rent. The average net investment on which interest on capital owned is determined is the average net worth of the business. It is the sum of the assets (not including real estate), less the sum of the liabilities (not including capital stock, surplus of a corporation, or undivided profits). The assets include cash, notes and accounts receivable, net inventories of merchandise, equipment and supplies, and prepayments. The liabilities include notes and accounts payable, and accrued items, such as unpaid taxes and interest. It is necessary that interest on capital owned and interest on capital borrowed be handled in the same way, if comparable figures are to be collected from a large number of businesses. If one merchant is operating entirely on his own capital and another borrows half the capital employed in his business, relative interest charges on the two businesses obviously can be compared only by deter-

mining the total interest charge for each. In any discussion of the costs of retail merchandising, it is necessary that a clear distinction be made between "expense" and "expenditure." Inasmuch as there is no outside liability incurred or expenditure made for interest on owned capital, proprietor's salary, or rent on owned store, some merchants believe that there should be no specific charge made for them. They are costs of retail merchandising, however, whether an actual outlay is made for them or not, and should be included as a cost of operation, not only that more accurate comparisons may be made between stores, but that the merchant may know the actual costs of his merchandising activities. The majority of merchants agree that it is advisable for each proprietor to charge his business with a salary equal to the amount he could earn if employed elsewhere; and charge as expense the rent on an owned place of business equal to that for which the place could be rented. Interest charges vary from 5 per cent for a common figure in jewelry stores to 1 per cent in grocery stores. In department stores, there is a tendency for these charges to decrease as the volume of sales increases. Stores doing less than $250,000 had interest charges of nearly 3 per cent in 1922, while those with sales over $10,000,000 had interest charges of less than 2 per cent. There is also a tendency for these expenses to vary directly with rate of stock turn, as shown in Tables 11, 12, 13, 14, and 15.

Supplies.—This item includes all supplies, such as water, gas, fuel, subscriptions to publications, and all other materials needed for the operation of the business. Department stores with sales over $1,000,000 have an expense for supplies of about 1 per cent and stores under $1,000,000 about .6 per cent. Specialty stores have supply charges of over 1 per cent of sales. In shoe and drug stores, supply costs are about .3 per cent.

Service purchased.—Heat, light, and power, when purchased from outside sources, and amounts paid for delivery service purchased are included under this item.

Unclassified.—Under this heading is included such expenses as membership dues, entertainment, inspection fees, donations, and welfare work which are not definitely provided for under other captions. This item averages about 1 per cent in the larger stores.

Traveling.—This includes traveling expenses incurred in connection with the operation and administration of the business.

Communication.—This heading includes all postage (except parcel postage on packages delivered), telephone, telegram, and cable charges.

Repairs.—This item includes the cost of repairs to buildings, fixtures, and equipment. It consists of all ordinary repairs to buildings and equipment for which depreciation has not been provided, and which restores the property or equipment to serviceability. New equipment or improvements should be charged to capital assets and not included as a cost of doing business.

Insurance.—The cost of all types of insurance, except that which is provided for under rent, is included in this item. The common figure for insurance is approximately .2 per cent in grocery stores and .5 per cent in department stores.

Depreciation.—Under this caption is included the amount which is considered a fair estimate of loss in the value of all store and warehouse equipment, and of the fixtures used in the operation of the business. Reserves for losses from debts owed by customers are also included under this item. Nearly all stores follow the practice of charging a fixed percentage of depreciation yearly on the original cost of fixed assets. The depreciation on store and warehouse equipment and fixtures amounts to about .6 per cent of sales. Losses from bad debts amount to .2 or .3 per cent of net sales. In stores of $1,000,000 and over the losses from bad debts in the year 1922 were .2 per cent of net sales with a range from below .05 per cent to 1 per cent.

Professional services.—This division includes the cost of legal advice, professional auditing, secret service, advertising services purchased, credit information and collection costs, and all miscellaneous professional services.

Total expense.—The total expense incurred in a typical jewelry store reporting to the Harvard Bureau of Business Research, with sales of $50,000 in 1922, amounted to $20,000. Of this amount $5,550 was expended for wages of sales force; $2,150 for advertising; $650 for supplies; $250 for delivery; $3,500 for buying, management, and office salaries; $2,400 for rent; $2,350 for interest; and $150 for losses from bad

debts. For a typical retail shoe store with sales amounting to $120,000 in 1922, the total expense was $32,760. This total included $12,840 for wages of sales force; $2,620 for advertising; $5,360 for buying, management, and office salaries; $3,600 for rent; and $240 for losses from bad debts. A typical department store with net sales amounting to $2,500,000 in 1922 had total expenses of $715,000, according to the figures shown in Table 6. This total included $385,000 for salaries and wages; $72,500 for rentals; and $72,500 for publicity. These three classes of expenditures represent 74 per cent of the total expenses of a typical department store of this size.

Functional Classifications.

The functional grouping of expenses follows very closely the natural operating functions of the retail store and affords easy comparison and effective control. Figure 5 shows the functional classifications of expense according to natural divisions. This is the form used by the Harvard Bureau of Business Research in collecting the expense figures for department stores. The spaces marked XXX indicate that there are no subdivisions of the natural expenses under that particular functional group. The figures appearing on the form represent the percentage of expense for each of the subdivisions.

The administration and general group includes expenses that are incurred for the general administration of the business, such as executive office, accounting office, credit office, superintendence, and general store expenses. The total of these tends to decrease with the volume of business, varying from 8.3 per cent in department stores under $1,000,000 to 6.1 per cent for stores over $10,000,000 in 1922, as shown in Table 9. The range in the smaller store was from below 5 per cent to above 12 per cent and in the larger store from 5 per cent to 9 per cent.

The occupancy group includes those items of expense which have to do with the general upkeep and operation of the store buildings, fixtures, and equipment. The expenses for this group tend to increase with sales volume, from 4.5 per cent in department stores under $1,000,000 to 5.7 per cent in stores over $10,000,000.

The publicity group includes those expenses that are incurred in order to inform the public of the merchandise offered for

TABLE 9

TOTAL OPERATING EXPENSES BY FUNCTIONAL GROUPS IN DEPARTMENT STORES *

Net Sales = 100 Per Cent.

	Net Sales Less Than $1,000,000		*Net Sales More Than $1,000,000*	
	1922	*1923*	*1922*	*1923*
Number of stores	109	57	87	82
Administrative and general	8.3	7.9	7.0	6.5
Occupancy	4.5	4.7	5.2	5.1
Publicity	3.0	3.3	3.7	3.9
Buying	1.7	2.0	3.1	3.2
General selling	9.1	9.0	8.4	8.5
Delivery	0.5	0.7	1.2	1.2
Total expense	27.1	27.6	28.6	28.4

* Bureau of Business Research, Harvard University, *Bulletins Nos. 37, 44.*

sale and of the general policy of the store. In department stores under $1,000,000 the publicity expense ranged from below 1.5 per cent to above 6 per cent, with a common figure of 3 per cent. In stores over $1,000,000 the range was from 2 per cent to 6 per cent, with a common figure of 3.7 per cent.

The buying group includes such expenses as are incurred in the purchasing, receiving, and marking of merchandise. A common figure of 1.7 per cent is found in the smaller department stores.

The selling group covers all of the expenses necessary in the selling of merchandise from the time it is received in the department up to and including the cost of delivery to the customer and any adjustments made thereafter. Selling expense may be divided into general selling and delivery. The general selling expenses are those incurred in the actual sale of merchandise, and the delivery expenses are those that have to do with the delivery of merchandise to customers. General selling expenses showed a common figure of about 9 per cent in the smaller stores and 8.4 per cent in the larger stores in 1922. Total delivery for stores under $1,000,000 was .5 per cent, and for stores over $1,000,000, 1.2 per cent for the same year.

Distribution and Proration of Expense.

It is generally recognized in the retail field that, in so far as possible, expenses should be distributed to the selling department for which they are incurred. Merchants want to know at all times whether a selling department is producing sufficient revenue to justify its existence; this can be ascertained only by charging it with its fair proportion of all expenses. In order to standardize the procedure, so as to make possible comparison between stores and departments of stores, the Controllers' Congress has adopted a plan for the distribution of expenses to the several departments. This plan provides (1) that all stores include like merchandise in the same department; (2) that the same accounts be carried for direct expenses, and that these expenses be charged to the same selling departments; and (3) that the same accounts be carried for indirect expenses, and that these expenses be distributed or prorated to the selling departments on the same basis. Furthermore, under this plan, the larger stores can carry a more detailed and a finer analysis than the smaller ones, and still be able to combine the numerous accounts into the few classifications required by the smaller stores. Although the plan is detailed and seemingly complex, it is based upon the very logical and simple principle that, in so far as possible, the distribution of all expenses should be made directly to selling departments, and that the indirect items of expense should be prorated to the different departments on one of the following bases:

(*a*) Volume of sales.
(*b*) Volume of cost purchases.
(*c*) Average stock.
(*d*) Value of space occupied.
(*e*) Space used.
(*f*) Packages delivered and returned.
(*g*) Value of equipment used.
(*h*) Total transactions.
(*i*) Total charge transactions.

Wherever possible, the basis used for the distribution of expense should be that which is most equitable to the different

departments and at the same time not involve too much detail. The standard plan provides different bases for four different-sized stores. The major items of expense are distributed as follows:

Administration.—This expense, with the exception of interest, insurance, and taxes, is prorated to the selling departments on the basis of the net sales of each department. Interest, insurance, and taxes on merchandise are prorated on the basis of the average stock carried during the period. In the smaller store all administrative costs are distributed on the basis of net sales.

Occupancy.—Rental charges listed under this caption should be distributed to the various selling departments and display windows on the basis of the predetermined comparative rental value of space occupied. The total amount charged to rentals should represent the amount paid as rent for the properties used in the conduct of the business, or the occupancy value of such properties in case the property is owned. It is only by the inclusion of rentals in the expense of a business which is owned that a merchant can determine the amount of profits arising out of merchandise operations. Generally speaking, the assignment of rental values to different floors, or to different locations on the floor, is arbitrary, but a fair disposition can be made by a consideration of the factors which make a space more valuable for merchandising activities. It seems reasonable to assign different rental values to different floors. The proportion of the total rental which is assigned to each floor depends upon the height of the building and the type of transportation service available; that is, the number of elevators, escalators, and stairways. Usually, the floors decrease in value with their height above the ground, depending upon the adequacy of the elevator service. A survey of nine stores shows no uniform method of distribution of rent, in fact, no two do it exactly the same. One store made no attempt to allocate rent and only two charged rent to window space. The following methods were used:

1. Floors allotted percentages, zones on each floor, and then square-foot basis applied.
2. Actual square-foot basis.
3. On basis of total sales.

4. Floors allotted percentages and then each floor divided on square-foot basis.
5. On basis of counter feet.
6. Cubic-foot basis.
7. Weighted cubic-foot basis.

The table below shows the percentages allotted to floors in each of six stores:

	Basement	Street	2nd	3rd	4th	5th	6th	7th	8th
1........	6.0	50.3	25.1	12.3	6.3				
2........		30.0	30	15	15	10			
3........		50	30	12	8				
4........		25	25	25	12.5	12.5			
5........		20	20	18	16	13	13		
6........	19.2	17.3	12.4	12.4	12.4	12.9	10.8	Offices	3

Despite this lack of uniformity, there is a tendency to distribute rent on either a weighted, or an actual, square-foot basis. Some selling space in stores is much more desirable than others. It seems reasonable, then, to assign different values to different parts of floors, the variation in those values being governed by such factors as lines of traffic, due to layout of aisles and position of elevators, stairs and escalators, lighting facilities and ease of access and egress. The locations of higher value are easily determined and the matter of fixing the amount of variation is not difficult. For example, a store in the Middle West distributes rent expense to floors as follows:

	Per Cent		Per Cent
Basement	15	4th floor..............	10
1st floor..............	35	5th floor..............	5
2nd floor..............	20	6th floor..............	5
3rd floor..............	10	Total	100

The amount of rent charged to each floor in this store is further prorated to the various departments, by weighting their locations on the basis of 50 for all departments facing main aisles, 30 for those sections on cross aisles, and 20 for certain departments that have poor light or are cut off from the main routes of traffic by partitions or jogs in the building. The controller in this store maintains that, in order to run the store successfully, he must know exactly what it costs to run each

department. Some merchants contend that a store may be laid out so that all departments are assigned locations equally desirable, provided the plans give proper consideration to the relation of departments to one another. It is held that in every store there is an ideal location for each department. The proponents of this theory claim that a department should be located in its proper place rather than that different rental values be charged to different locations.

Inasmuch as rental charges are prorated to departments for the purpose of internal control and do not represent actual payments, the method of evaluating floor space has perhaps not received as much attention as the proper evaluation of the store rent as a whole. It is important, however, to know whether a selling department is actually showing a profit, and this can be ascertained only by charging it with its fair proportion of expenses. As rental is charged only to selling, alteration, manufacturing, and window departments, it is advisable to establish a square-foot rental on the various locations and floors, excluding windows. After measuring the spaces occupied, the rental applicable to each can be readily computed. For example, if it is determined that the rent on the main floor is worth $1.50 per square foot, each department is charged this amount for the number of square feet occupied. In establishing the square-foot rental charge, remember that, in eliminating the service departments, the rentals of the space occupied by the other class of departments must be increased. The problem of the proper prorating of rental is more important and receives more attention in retail stores, where buyers are paid on net profit, than in those where they are paid on gross margin.

Non-selling departments are necessary, even though no revenue is shown, because they are not primarily for the purpose of earning direct profit. It is, therefore, necessary to charge the selling departments with more rent and other occupancy expenses. In laying out a store, the value of space devoted to non-selling departments should be carefully considered before their location is determined. The charge for repairs to equipment, consisting of the salaries and wages of carpenters, helpers, and material, is distributed as a direct charge to the selling department for which the repairs are made. The

remainder of the occupancy expense is prorated on the basis of floor space occupied by the selling department.

Window rental.—The expenses of the window display department, which includes all operating costs inclusive of floor-space rent, should be charged directly to the selling departments on the basis of arbitrary values of each window, according to display value, and the number of days the window is used. If, in a store with a total window value of $600 for a month, as determined by appraisal, a department used one window, valued at $5 per day, for six days, its total direct charge would be $30 for window rental or 5 per cent of the total. This department would, therefore, be charged with 5 per cent of the total expenses of the window department for the period. If the window rentals are distributed in accordance with the above plan, no loss or profit will accrue to the window department, as all of the actual expenses incurred will be charged to the selling departments which use the windows.

On the other hand, there are a large number of retail stores that make no charge for window rentals, but distribute the expenses of the window-display department to all of the selling departments on the basis of net sales. In these stores it is felt that the windows should be used to display the store rather than any particular department. Customers who are attracted into the store because of window-display purchase throughout the various departments. Inasmuch as some types of merchandise are better suited for window display, these stores feel that the display manager should be responsible for the display value and should schedule the different departments so as to get the most effective drawing appeal.

Publicity.—The charges for "newspaper" and "other direct advertising" should be distributed directly to the selling departments, in accordance with the work done for each of these departments. General advertising and circular advertising should be distributed on the basis of net sales. Some retailers charge all publicity to the departments on the basis of net sales rather than actual space used, because they feel that advertising is to induce people to come into the store rather than to buy any particular item of merchandise. Once a customer has entered the store, merchandise may be purchased from a large number of departments which have not advertised, as indicated by the fact that about 75 per cent of the

total sales are in unadvertised merchandise. For this reason, all departments should bear the publicity expense on the basis of sales rather than of space used.

On the other hand, if the departments are properly scheduled, as in window display, each department will do a certain amount of advertising and thus help to bear the publicity expense. There are, however, certain types of merchandise which do not make an effective advertising appeal and must necessarily depend upon location for their sales. When a department is charged for the space used, there is more of an effort to make an effective advertising appeal. Plans are better made and there is more preliminary analysis than when each department is allowed a certain amount of space without a specific charge. In so far as possible, a department should be charged with all direct expenses which it incurs, not only from the point of view of accuracy in accounting, but to stimulate those in charge of the expenditures to make as effective use of the money as possible.

Buying.—The distribution of buyers' salaries is secured from the payroll analysis, and charged to the selling departments accordingly. Buyers' traveling expenses and other direct expenses should be charged to the department having incurred the expense. The expenses of the merchandise office, foreign office, receiving, marking, and stock rooms should be charged to the different departments in the larger stores on the basis of monthly purchases at cost.

Selling.—The salaries and wages of salespeople, also P. M.'s, bonuses, and other forms of compensation should be distributed direct to the selling departments for which the expenditures were made. All other selling expenses, including adjustments and mail and telephone orders, should be distributed on the basis of sales volume. Delivery of packages includes all of the expenses incurred from the moment the package leaves the counter until it is in the customer's hands or is returned to the store. A record should be maintained of the number of packages delivered and returned from each department, and the total expenses for the monthly period should be distributed on this basis. Although the actual practice of stores varies widely as to the method of charging delivery expenses to the selling departments, there is a tendency in the more progressive stores to use a weighted number of

packages as a basis. A common practice is to classify all departments as to the nature of packages delivered. It is recognized that some types of merchandise cost more to deliver than others and, using one type as a unit, the other classifications are given a relative weight. These weights are arrived at by approximating the relative weights, size, and general nature of the average package in the different departments at periods during the year. Although these relative values are, to a large degree, arbitrary, they serve as a basis for a more equable distribution of expenses than simply to charge on the basis of the number of packages delivered. Some stores have only two classifications—bulk and small merchandise. In other stores furniture costs are kept separate, and the total expense for other delivery is distributed on the basis of the number of packages delivered.

In the distribution of expense to departments, a store should be governed by two major considerations: (1) that each department or line of merchandise should bear its proportionate share of the expenses which it incurs; and (2) that the method of prorating these expenses should not be unduly complex or costly. The store as a whole does not decrease its cost of operation by shifting the burden of expense from one department to another. The major importance of a proper distribution of expense is (1) that costs may be compared with other stores by subdivisions; and (2) that the store may know what lines are yielding profit and what are showing losses, so that the efficiency of the merchandise activities may be more accurately judged and compensated. By making accurate comparison of expenses with other stores, it is possible to locate more quickly those which are out of line, and to initiate corrective measures. The exchange of information between associated non-competing stores is especially advantageous, because they have usually adopted a standard merchandise classification and expense division so that accurate comparisons are made possible. Furthermore, the stores of these associations usually have similar characteristics as to type of merchandise handled and methods of operation.

The collection and interchange of this information is beneficial to the different stores, inasmuch as it gives certain guides by which a store may measure its comparative efficiency. It does not, however, take the place of internal research and

analysis of expense within the store itself. The practice of some stores has been to attempt to bring each expense down at least to the common figure of member stores. This has resulted in some cases in over emphasis on some expense figures which seemed above the average and a lack of emphasis on other expenses which in comparison with the common figure seemed low

Budgetary Expense Control.

Budgetary control means the direction of all the operations of a store by means of specific plans prepared in advance. These plans, which are contained in an instrument called a "budget," are a series of estimates on each of the major activities of the business over a definite period of time. With adequate records of past sales and expenses, it is possible to determine for a given period in advance approximately the total expense for a store as a whole and the percentages for the different subdivisions. The basis of an estimate of this kind is a record of operating costs for the preceding period by selling departments and expense divisions, and estimated future sales for a given period. In establishing a planned expense percentage for the different subdivisions comparisons should be made, not only with the past experiences of the individual stores, but with the ratios which have been obtained in other stores. The sales and operating costs should be estimated on reasonable expectations rather than a hoped-for business based upon too much optimism. Through the interchange of expense figures between non-competing stores and the studies of private associations and universities, there have been established standards of operating costs which serve as dependable guides in establishing an expense budget.

Budget committee.—In order that the budget may function effectively, it is necessary that nominally it be placed under the direction of an executive, who is independent and superior to all departmental executives. In stores where a functional organization exists, the budgetary program is usually made by a committee consisting of the principal functional executives with the president or general manager as chairman. After the total expenses of the store have been divided into controllable sections, each executive is made responsible for

BUDGET OF OPERATING COSTS														
MONTH	FEB. ~~AUG.~~		MAR. ~~SEPT.~~		APR. ~~OCT.~~		MAY ~~NOV.~~		JUNE ~~DEC.~~		JULY ~~JAN.~~		TOTAL	
	$	%	$	%	$	%	$	%	$	%	$	%	$	%
ADMINISTRATIVE														
EXECUTIVE OFFICE														
GENERAL OFFICE														
SUPT'S OFFICE														
GENERAL STORE														
TOTAL ADMINISTRATIVE														
OCCUPANCY														
HEAT, LIGHT POWER														
ELEVATORS														
CLEANING														
BUILDING REPAIRS														
GENERAL														
TOTAL OCCUPANCY														
PUBLICITY														
ADVERTISING WAGES & NEWS														
DECORATING														
GENERAL														
TOTAL PUBLICITY														
BUYING														
BUYING WAGES														
RECEIVING ROOM														
SPECIAL														
GENERAL														
TOTAL BUYING														
SELLING														
SELLING WAGES														
ADJUSTMENTS														
DELIVERY ROOM														
AUTOMOBILE DELIVERY														
GENERAL														
TOTAL SELLING														
TOTAL OPERATING COST														
EXPECTED SALES														

Fig. 7—Budget of Operating Costs.

keeping the expenses in his section within the budget. For instance, the head of the selling department is made responsible for general administrative expenses prorated to his department. It is essential that the head of each functional division make an estimate, before the beginning of the budget

period, of the anticipated expenses of this department, and that these estimates be reviewed by the budget committee. If necessary, the estimates should be revised before they are made a part of the financial budget of the store. The success of a budget depends largely upon the attitude of the division managers, not only in preparing the preliminary estimates, but in their coöperation in making current adjustments during the budget period. If they have had a part in the making of the forecast they will take more interest in adhering to the planned figures.

Operation of the budget.—After the expense forecast has been accepted by the budget committee, provisions should be

DEPARTMENTAL OPERATION BUDGET

Dept No.	Description	Planned Sales	Planned Markdowns %	Planned Markdowns $	Gross Stock Removals Sales + MDs	Standard of Initial Mark Up %	Cost of Goods Sold	Maintained Gross Margin $	Maintained Gross Margin %	Cost of Operation: Adm.	Occu.	Publicity	Publicity: Other	Publicity: Total	Buying: Wages	Buying: Other	Buying: Total	Selling: Wages	Selling: Other	Selling: Total	Total %	Total $	Net Profit $	Net Profit %	Stock Turns	Average Stock Retail
1	JEWELRY	19450	6	1167	20617	42	11958	7492	39	4^{47}	3^{44}	4	0^{24}	4^{24}	2^{4}	4^{41}	6^{81}	5	1^{1}	6^{1}	25^{1}	4886	2604	13^{4}	1^{5}	12966
2	TOILET GOODS	20240	3	607	20847	26	15635	4605	23	4^{47}	3^{44}	3	0^{24}	3^{24}	2^{3}	4^{44}	6^{71}	4	1^{1}	5^{1}	23^{0}	4659	54	0^{27}	1^{5}	13494
3	NECKWEAR	11968	5	598	12666	42	7288	4680	39	4^{47}	3^{44}	3^{5}	0^{24}	3^{74}	3	4^{41}	7^{41}	8	1^{1}	9^{1}	28^{2}	3377	1303	10^{9}	1^{3}	9206
24	RIBBONS	9260	4	370	9630	40	5778	3482	38	4^{47}	3^{44}	2	0^{24}	2^{24}	2^{9}	4^{41}	7^{31}	8	1^{1}	9^{1}	26^{6}	2465	1017	11^{0}	1	9260
25	NOTIONS	9784	3	294	10078	40	6047	3737	38	4^{47}	3^{44}	3^{5}	0^{24}	3^{74}	2^{5}	4^{41}	6^{9}	6^{5}	1^{1}	6^{6}	26^{2}	2565	1182	12^{1}	1^{5}	6522
26	GLOVES	13440	4	558	13978	36	8946	4494	33	4^{47}	3^{44}	3	0^{24}	3^{24}	2^{6}	4^{41}	7^{01}	6^{5}	1^{1}	7^{6}	25^{8}	3470	1024	7^{6}	1	13440

Fig. 8—Departmental Budget.

made for a periodical comparison between actual and planned performances. In some stores monthly figures are issued to division heads, who are required to explain any deviation from the estimated figure. In other stores, the requisitions and cash vouchers are routed through a central office and no expenses paid unless they have been passed by the head of the expense control committee. In the control of expenses, the budget may be used as a maximum limit, absolute for the budget period, or merely a desirable attainment. Accurate predetermined calculations are essential to the ultimate success of an expense budget. Because of changing conditions, however, a margin should be allowed for additions to, and reductions from, the established limits. Restrictions upon legitimate increases in expenditures for operating expenses will defeat the purpose for which a budget is established.

Figure 7 shows a convenient subdivision of expenses based upon the functional classifications. After the expense ratios have been determined for a store as a whole, they may be distributed to the various divisions, as shown in Figure 8. In

some stores the reverse procedure is used and budgets are drawn up for the different functional divisions first and then combined to form the total store budget. In case the total planned expense for the season is found to be larger than desired, the separate estimates for the functional divisions may be readjusted. After the estimates of operating costs have been made, they may be summarized on the form shown

SUMMARY FOR TOTAL STORE							
	FEB. ~~AUG~~.	MAR. ~~SEPT~~.	APR. ~~OCT~~.	MAY ~~NOV~~.	JUNE ~~DEC~~.	JULY ~~JAN~~.	TOTAL
GROSS STOCK REMOVALS (SUM OF SALES AND MARKDOWNS)							
MARK-DOWNS							
SALES							
COST OF GOODS SOLD GROSS STOCK REMOVALS REDUCED TO COST VALUE							
MAINTAINED GROSS MARGIN SALES MINUS COST OF SALES							
COST OF OPERATION							
NET PROFIT							

Fig. 9—Summary for Store.

in Figure 9, giving the net profit by months for the store as a whole.

Although the principles of expense budgeting are comparatively simple and have been used by some stores for several years, only a small percentage has adopted any systematic budgetary procedure. In a study of more than two hundred stores made by the Controllers' Congress of the National Retail Dry Goods Association in 1923, it was found that only

seventeen per cent were using a budget for expense, and that the budget was confined almost exclusively to stores with sales volume in excess of $1,000,000. Most of the stores reported that the estimates of expense came from the controller, the general manager, or a special committee. All of the stores having expense budgets used sales as a basis. These stores reported that current or actual expenditures were compared with the budget at monthly intervals, although a few made the comparison weekly and then revised the budget to meet present conditions. The approximate cost of budgetary procedure as reported by these various stores ranged from no additional expense to $150 per week.

One of the major advantages of an expense budget is that it helps to coördinate the activities of the separate functions of a store, by bringing together the heads of the different functional divisions in a discussion of total expenses. Since the budget is made up of estimates prepared by those who are to operate the several parts of it, a definite responsibility is placed, requiring logical explanation of increases of expense over planned figures. The preparation of a budget focuses the attention of executives on the future operation of their departments and makes necessary a study of past performance as compared with that of other stores, thus substituting planning for post-mortem analysis

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Problems.

1. In the early part of 1923 a group of small department stores in the New England States formed an association for the purpose of exchanging merchandise and expense figures. The annual sales volume of these stores ranged from approximately $600,000 to $2,200,000. A

committee was appointed to draw up a standard classification of expenses as a basis for exchanging comparable information. It was decided to use the standard classification of accounts for expenses which was adopted by the Controllers' Congress of the National Retail Dry Goods Association.

(*a*) How should the following expense accounts be grouped for comparison?

Rent of store building.	Boiler insurance.
Rent of garage.	Electric light.
Executives' salaries.	Traveling expense of buyer.
Wages of salespeople.	Interest.
Wages of stock clerks.	Parcel post.
Office supplies.	Salary of merchandise manager.
Advertising space.	Wages of packer.
Fire insurance on merchandise.	Sales books.
Wrapping paper and twine.	Losses from bad debts.
Salary of window-display manager.	Rent of New York buying office.

(*b*) On what basis should each of the above expenses be prorated to selling departments?

(*c*) One of the store owners in this group is not in favor of making a subdivision of expenses. He wishes to compare total expense figures only. It is his opinion that the subdivision of expenses is for internal operation only and that no type of classification will in any way increase or decrease the total expense figure.

What specific advantage may these stores expect from a comparison of expense percentages by subdivisions?

(*d*) Why should the expenses be prorated to the different selling departments?

2. The Fair shoe store, in 1923, had sales amounting to $58,000, but the operating statement showed a loss of $1,914. The proprietor is making a careful analysis of each expense in order to determine whether any of the items are out of line. The following figures represent the major items of expense: salaries and wages $9,396; advertising $1,392; rent $2,262; taxes $348; total interest $1,856; total expense $17,458. The store had a stock turn of 1.6 times for the year.

(*a*) If this store had maintained a gross margin as high as the common figure for shoe stores reporting to the Harvard Bureau of Business Research in 1923, Table 8, would it have shown a loss?

(*b*) Are the expense percentages out of line with those shown in Table 8?

3. The Brown department store had a sales volume of $700,000 in 1923. Its operating expenses by functional groups were as follows:

Administrative and general \$69,800; Occupancy \$35,000; Publicity \$35,000; Buying \$13,000; General selling \$80,000; Total delivery \$3,500.

How do these expenses compare with the common figures for stores with sales under \$1,000,000 as shown in Table 6?

4. The Hayne department store in 1923 had net sales amounting to \$1,000,000. The expense percentages for the fourteen natural divisions were approximately the same as the common figures for stores under \$1,000,000 reporting to the Harvard Bureau of Business Research in 1923. In reviewing the operations for 1923 the controller was of the opinion that the expense percentages were as low as might reasonably be expected. The sales plan for 1924 calls for an increase of 25 per cent over 1923 with a stock turn of 3 times as compared with 2.5 times for the previous year. The controller feels that with this increase in sales volume certain expense ratios should materially decrease, whereas some may remain constant.

Draw up a budget for this store for 1924 for the fourteen natural divisions of expense.

5. At a meeting of the executive council of the Marsh department store the subject of budgetary control of expenses was discussed and the controller, Mr. Bane, was instructed to present a report at the next weekly meeting outlining a complete budgetary program. Although the Marsh store does an annual business of \$11,000,000, it has heretofore used no regular plan for budgeting expenses. The following gives in part Mr. Bane's suggested plan: [1]

The budgetary procedure for expenses will be under the authority and direction of the budget committee, consisting of the general manager as chairman, the merchandise manager, the store superintendent, the personnel director, and the controller.

(1) The budget will first be prepared by detailed expense classifications. Forms will be devised by the budget committee on which the estimates are to be returned. The actual expense for the past year will be filled in by the budget committee from figures furnished by the accounting department.

(2) About sixty days before the beginning of the six-months' budget period, the budget committee will send these forms to the executives in charge of each of the store divisions. Each executive will be requested to return the estimates of expense for all of the departments for whose operation and control he is responsible. He will be issued a form for each of the expense classifications coming under his control.

(3) The head of each controllable section, in conference with his subordinates, will work out the details of his requirements. The

[1] *Harvard Business Review*, October, 1923, pp. 102, 103.

procedure followed will vary according to need. Non-selling pay-roll items will be worked out on the basis of a planned organization of regular and special employees, a schedule of increases to be allowed, vacations, overtime, and extra remuneration. Estimates of supplies will be based on the average consumption of the different kinds of supplies used, at the approximate cost. Fixtures and equipment requirements and department changes will be anticipated whenever possible.

(4) Forms with estimated requirements filled in will be returned by the subexecutives to the executive in charge of each controllable section, who will then make a summary of the estimates by expense classifications for his division. All estimates and summaries will be turned over to the budget committee.

(5) The budget committee will check the estimates and revise them where necessary. The revised estimates will then be submitted to the head of the controllable section for his approval.

(6) The detailed expense estimates will be tabulated in summary form, totals being given, first, by the five functional divisions, and, second, by the fourteen natural divisions within the functional divisions.

(7) The estimated budget of expenses will be considered by the budget committee and such changes as are deemed necessary will be made.

(8) After the estimates have been approved by the budget committee, they will be submitted to the management and finally to the board of directors. The approved estimates will then become the expense budget for the store.

(9) The executive in charge of each controllable section will be given the approved figures and will be held responsible for the control of expenditures in his respective division or departments within the amount allotted to him in the accepted expense plans.

The budget committee controls the budget and is definitely responsible for keeping the planned expenditures within the limits set by the store budget. As soon as the budget has been accepted, it will notify the different departments and division heads of their respective spending powers. The budget committee will issue monthly figures to division heads to be filled in on these forms. These forms, which each section manager is required to keep up to date, will give him information at all times as to the conditions within his own controllable section.

In order that the budget committee may exercise full control, it is essential that it be apprised of every expenditure. While this purpose may be accomplished in several different ways, it is thought that the most effective way, and the one which offers the least opportunity for errors, will be to route all requisitions and cash vouchers through the expense office. Where this method is followed, no payment of pay-roll

or non-pay-roll expense will be made unless it has been passed by the budget committee. A record of every expenditure will be entered against the department incurring the expense, and a deduction of the amount expended will be made from the department's budget. This record will be checked up daily. In passing on a requisition, the necessity for the expenditure based on the department's condition is the first consideration.

(*a*) Does the plan outlined by Mr. Bane in any way curb the initiative of divisional heads?

(*b*) Does the plan provide the necessary check on expenditures?

(*c*) Should any changes be made in Mr. Bane's report?

Chapter V

THE RETAIL METHOD OF INVENTORY

In order to determine profits, it is necessary to know sales and cost of sales. Inventory at the beginning of a period, plus purchases, minus inventory at the end, gives the total cost of merchandise sold, which, subtracted from sales, gives the gross margin. The accuracy of the figure representing profit earned during a period is directly dependent upon the proper valuation of opening and closing inventory. The relation of profit and the value of inventory is well illustrated by the following condensed profit and loss statement:

Net sales		$14,300
Net inventory of merchandise at beginning of period	$ 9,400	
Purchases at net cost	13,000	
Freight and cartage	100	
Net cost of merchandise handled	$22,500	
Net inventory at end of period	13,000	
Cost of merchandise sold		$ 9,500
Gross margin		4,800
Total expense		4,500
Net profit		$ 300

If the inventory at the end of the period is valued $300 lower than its real worth, the cost of merchandise sold would be $9,800, and the gross margin $4,500. Since the expenses in the illustration above are $4,500, there would be no net profit. On the other hand, if the closing inventory were valued $300 over its actual value, the net profit would be $600 instead of $300. Since the net profit is so directly dependent upon the valuation of the opening and closing inventory, it would seem that profits may be increased or decreased by simply manipulating these inventories. Any variation from the actual value of closing inventory of one period would give only a paper profit, which would necessarily decrease the profit during a subsequent period. If the inventory were valued at $13,300 instead of its actual value of $13,000, the net profit would be

$600 instead of $300. The next period would then open with an inventory overvalued by $300 which, at some time, would necessarily be written down to its actual value. The importance of distinguishing between true and net profits was especially emphasized as a result of the income and excess-profits taxes. If inventory of merchandise at the close of a period were overvalued, taxes would be paid on profits that actually were not earned. Similarly, if inventory were understated, too small a tax would be paid.

Book Inventory.

For the proper management of a store, it is desirable to have available at all times figures showing the amount of merchandise on hand. There are various ways in which such book figures may be secured.

Methods of obtaining.—1. A system of stock records may be kept in such a way as to provide a perpetual book inventory in physical units. Such a system will show at any time what particular units of merchandise have been sold and what are still on hand. In most stores the records necessary to maintain a physical check by units entails more expense than is justified by the results. This is especially true in lines where the units are small in value.

2. A cost audit of sales may be made, by accumulating from day to day the cost of merchandise sold. The cost price of each article sold may be recorded by the sales department and these figures audited in the same manner as the retail sales. By subtracting the total cost of goods sold from the retail sales a gross margin figure may be found. At any time the cost of goods on hand may be found by subtracting the cost of goods sold from beginning inventory plus purchases. This figure may be used to check for inventory shortages when physical inventory is taken and also to assist in the planning of purchases. Such a figure, however, does not show the amount of merchandise depreciation, unless the cost records have been adjusted to changing market prices.

3. Reduce the net sales figure to cost by subtracting from it the amount that represents the difference between the cost and selling price, or the mark-up. If the maintained mark-up is known, it may be applied to reduce the sales figure to an

approximate cost of merchandise sold, and from this figure the cost of merchandise on hand may be found. This plan usually proves unsatisfactory, because of the difficulty in approximating the maintained mark-up percentage. In case the original retail price is changed by subsequent mark-up or mark-down, it becomes extremely difficult to determine what part of the merchandise so changed has been sold and what part remains in stock.

4. In the large stores the retail method of inventory is used. When the income tax legislation was first put into effect, a number of the larger department stores had been using for several years a selling-price method of merchandise accounting. In order to secure the Treasury Department's recognition of the retail method of inventory, several of the larger retail stores, working through the National Retail Dry Goods Association, obtained a series of decisions from the Internal Revenue Department. The following letter, issued by the Treasury Department in 1923, answers most of the major questions arising from the adoption and use of the retail method:

TREASURY DEPARTMENT

Office of Commissioner of Internal Revenue
Washington, D. C.

March 23, 1923.

IT: Mimeograph
Coll. No. 3077
R. A. No. 249

Inventories of Retail Dry Goods Dealers.

TO COLLECTORS OF INTERNAL REVENUE,
INTERNAL REVENUE AGENTS IN CHARGE,
AND OTHERS CONCERNED:

Attention is invited to the provisions of Treasury Decision 3296, amending Article 1588 of Regulations 45, and to Article 1588, Regulations 62, dealing with the "retail method" of pricing inventories.

Numerous inquiries have been made with respect to the scope of the article, and accordingly this mimeograph is issued with a view to explaining some of the questions most frequently arising.

Article 1588 provides that any retail merchant may employ the "retail method" of pricing inventories, provided, that the use of such method is designated upon the return, that accurate accounts are kept, and that such method is consistently adhered to. If a taxpayer elects to change from the "cost" or "cost or market" basis to the "retail method," such method will not be recognized, unless it has been regularly followed and records properly kept throughout the entire accounting period for which return is made.

The "retail method" is essentially a cost method of valuing inventories, but the rule is not inflexible. On a constant or rising market, it is approximately a "cost" method, but on a falling market it may result in a reduction to "cost or market, whichever is lower."

The provisions of the regulation providing that accurate records must be kept contemplates that certain records shall be kept by departments in permanent form for the inspection of internal revenue officers. Purchase records should show the firm name, date of invoice, invoice cost, and retail sales price. A permanent record should also be kept of the accumulation of all department purchases, mark-downs, sales, stock, etc.

Under the retail method the goods in the inventory are ordinarily priced at the selling prices, and the total retail value of the goods is reduced to approximate cost by deducting the percentage which represents the difference between the retail selling value and the purchase price. In order to compute this percentage properly, goods should be recorded by departments at two prices: (a) invoice price plus transportation, and (b) original retail price. The total purchase mark-up for the accounting period is the difference between

Cost: Inventory at the beginning of the period,
+ Purchases at cost,
+ Transportation,
and
Retail: Inventory at sales price,
+ Purchases, at sales price.

This total mark-up, divided by the total retail value, will give the percentage of purchase mark-up. Under no circumstances should arbitrary standard percentages of purchase mark-up

be used, but such percentage must be the mark-up percentage, computed as accurately as possible from the department records of the accounting period for which the return is made.)

The article also provides that, in computing the percentage above mentioned, proper adjustment should be made for all mark-ups and mark-downs. This means mark-ups and mark-downs with respect to original retail price. It contemplates that it is proper to add in computing the percentage, as a part of the original retail sales price, the actual increase in such price which has been brought about by market conditions and by incorrect pricing when the goods were put into stock. For the convenience of the examining officer, a special form should be provided in which complete information by items of the increase from the original retail should be shown and reference, if possible, made to the original invoice and entry, and the reason for the increase freely explained. Entry of such increased retail properly belongs in department purchase books, although it may be set up as a separate item in the accumulated records of the department. The same forms that are used to record such price increases should not be used for mark-downs, and in no instance will a store be allowed to include as retail increases a mark-up which has been taken as a correction or cancellation of a mark-down; such mark-up must be regarded and treated in all cases as opposite to mark-downs.

With respect to mark-downs, these will be recognized where the procedure is proper and consistent. The procedure with regard to mark-downs will be deemed proper if in any fiscal year or period of that year the goods so marked down are in proportion to current sales, to stock on hand, to mark-downs of corresponding months of the preceding year, or if evidence can be submitted as to market changes which have forced a reduction in retail prices to bring about a parity with the selling price of the same goods which have been purchased at a reduced cost. Arbitrary mark-downs made to provide for depreciation and obsolescence of goods in inventory will not be recognized. Mark-downs made for this purpose will be allowed only by actual offering of the goods to the public at such reduced prices. In this connection, see Article 1582 of Regulations 62.

It is recognized that where, in changing from the cost

method of computing inventories to the retail method, the opening inventory is not computed at retail, a book profit results for the year in which the change is made which is clearly not income realized from operations, or gain within the meaning of the Revenue Acts, and which need not therefore be included in the income for the year, provided the taxpayer has kept accurate records showing such unrealized income and in filing the return the items are clearly set up in a rider attached to the return.

D. H. Blair,
Commissioner.

How the Retail Method Operates.

Under the cost plan of inventory, goods in stock are valued at cost or market, whichever is lower, since most stores consider it a conservative policy to anticipate losses, but not to anticipate profits. Under the retail method, inventory is taken at the selling price only, rather than at the cost or market. In a department store using the retail method of inventory, separate records are kept for each department or classification of merchandise. The usual procedure is as follows:

Actual inventory at the beginning of a period is entered at cost and retail figures, and all purchases during the period are accumulated and entered at both cost and retail. The total retail figure is adjusted to take care of additional mark-ups, and additional mark-up cancellations, due to incorrect pricing when goods were put in stock or to a change in market conditions. At any time there are available total cost figures and total retail figures for all merchandise handled during the period. The difference between the cost and the retail figures is the amount of mark-up which, divided by the total retail figure, will give the percentage of mark-up on retail. This is called the percentage of purchase mark-up. From the total retail figure is subtracted net sales, plus mark-downs, less mark-down cancellations for the period. The remainder is the retail value of merchandise that should be on hand. A physical inventory is then taken by listing the retail figures appearing on the tickets of the merchandise in stock. The book figure of retail inventory on hand and the physical inventory should agree. Any discrepancy is called a stock shortage or overage as the case may be. By applying the complement of

the percentage of purchase mark-up (100 per cent — mark-up per cent) to the actual retail inventory figure, a derived cost of inventory on hand is obtained.

On the accuracy of the cumulative purchase mark-up hinges the accuracy of the entire retail plan. Inasmuch as the retail method is a system of averages, it assumes that the sales of a department in any period are uniformly representative of the merchandise regularly carried in that department and bear about the same average mark-up. Although this condition never actually exists, as a study of a department's figures will show, it is justified by the law of averages and is sufficiently accurate to give derived cost value of merchandise on hand. The accuracy of the retail method of inventory depends upon a proper departmentalization and classification of merchandise with reference to varying mark-ups and turnover rates—the greater the merchandise classification, the more accurate the results will be. The form shown in Figure 10 for computing inventory according to the retail method has been approved by the Controllers' Congress of the National Retail Dry Goods Association as conforming to the ruling of the Treasury Department. By applying figures to this form the several relationships are shown.

	Cost	*Retail*	*Mark-up*	*Per Cent of Mark-up*	*100 Minus Mark-up*
Opening inventory	$ 4,000	$ 5,000	$1,000	20	80
Purchases	8,000	12,000	4,000	33⅓	66⅔
Freight, express, and cartage inward	400				
Additional mark-up (net)......		100			
Total of inventory plus addition	12,400	17,100	4,700	27.49	72.51
Net sales		13,200			
Mark-downs (net)		200			
Total retail deduction.........		13,400			
Resultant retail inventory......		3,700			
Cost of inventory (72.51% of 3,700)	2,682.87				
Gross cost of merchandise sold (12,400 — 2,682.87)	9,717.13				
Gross margin (13,200 — 9,717.13)	3,482.87				

The retail method requires that the selling price be fixed definitely upon the arrival of the merchandise, and that any subsequent variation in this price be accurately recorded. The original purchase mark-up is assumed to be the fair and proper

relation between cost and retail. Thereafter, the relationship thus fixed is maintained, even though the selling price is reduced by mark-downs to move the goods. The opening inventory figure is the actual physical inventory at cost and

	(1) Cost	*(2)* Retail	*(3)* Mark-up	*(4)* Per cent of Mark-up
1. Opening inventory (lines 9 and 10 of preceding period)	.... ..	.... ..	.... ..	.... ..
2. Purchases	.... ..	.... ..	.... ..	.... ..
3. Freight, express and cartage, inward	.... ..	xxx xx	xxx xx	xxx xx
4. Additional mark-ups, less additional mark-up cancellations	xxx xx	.... ..	xxx xx	xxx xx
5. Total of inventory, plus additions	.... ..	.... ..	.... ..	.... ..
6. Net sales	xxx xx	.... ..	xxx xx	xxx xx
7. Mark-downs, less mark-down cancellations	xxx xx	.... ..	xxx xx	xxx xx
8. Total retail deduction (sum of items 6 and 7)	xxx xx	.... ..	xxx xx	xxx xx
9. Resultant retail inventory (retail inventory on line 5, column 2, minus item 8)	xxx xx	.... ..	xxx xx	xxx xx
10. Calculation of cost percentage:				
(a) Total percentage 100%				
(b) Percentage of mark-up (line 5, col. 4) ....%				
(c) Percentage of cost [(a) minus (b)] ....%				
11. Cost inventory (item 10 (c) applied to item 9)	.... ..	xxx xx	xxx xx	xxx xx
12. Resultant mark-up and percentage (item 9, minus item 11)	xxx xx	xxx xx	.... ..	.... ..
13. Gross cost of merchandise sold (difference between cost inventories on lines 5 and 11)	.... ..	xxx xx	xxx xx	xxx xx

Fig. 10—Formula for Retail Inventory Method.

retail after all adjustments have been made at the close of the preceding period. As shown by the form above, freight, express, and cartage inward are considered a part of the original cost of merchandise. Additional mark-ups are those brought about by (1) incorrect pricing when the goods were originally placed in stock; or (2) a change in market conditions. Mark-

up cancellations are subtracted from mark-up, so that the retail column will show the net retail figure.

In the above example, the total cost of merchandise handled is \$12,400 and the total retail price \$17,100, giving a purchase mark-up of 27.49 per cent. This is presumed to be the proper relationship between cost and retail, when the merchandise was put in stock. During the period, the retail inventory was decreased \$13,400 by sales and mark-downs, so that the resultant retail book inventory was \$3,700. By applying the complement of the purchase mark-up (100-27.49) to \$3,700 the inventory is reduced to a cost value of \$2,682.87. The total cost of merchandise handled, minus the amount remaining, gives the cost of merchandise sold, which, subtracted from net sales, gives a gross margin of \$3,482.87. Thus under this system the gross margin may be found at any time by the above procedure.

Mark-downs.—Mark-downs are deductions from the retail price. The total mark-down for a period should be reduced by the total mark-down cancellations in order to give the net mark-down figure. It is necessary, therefore, that those in charge of mark-ups and mark-downs clearly designate whether they are original changes or cancellations of previous changes. For instance, if ten articles are originally placed in stock at \$15 retail, and subsequently marked down to \$12 for a sale, eight selling for that price, and the remaining two marked back to \$15, the total mark-down is \$30, and the mark-down cancellation is \$6. Thus the net mark-down is \$30 minus \$6, or \$24. The individual identity of merchandise is lost when its cost and retail are added to the department's stock figures, but for purposes of figuring mark-up and mark-down cancellations correctly, these price changes must refer to the particular merchandise on which the changes were made. If an article originally priced at \$20 is reduced to \$18 for a special sale and the price later restored to \$20, the \$2 change in the second instance does not constitute an additional mark-up, but rather a mark-down cancellation. However, if the price of this article had been increased to \$22, \$2 would have been a mark-down cancellation and the other \$2 an additional mark-up. All price changes must be recorded in detail if the retail method is to function properly. The necessity of differentiating carefully between mark-up and mark-down cancellation is that an additional mark-up will affect the average percent-

age of purchase mark-up, whereas a mark-down does not affect this figure.

The original regulations governing the retail method of inventory stated that "mark-downs should not be included in the computation of the retail value of goods on hand, unless the goods so marked down have been actually sold." This prevented a buyer from arbitrarily decreasing his stock by mark-down just before physical inventory was taken for the purpose of decreasing his taxes. On the other hand, it was practically impossible for a buyer to make certain that all mark-down goods were sold. Subsequent modification in the ruling permits all mark-downs substantiated by record to be included, provided the merchandise had been handled properly. "The procedure with regard to mark-downs will be deemed proper if in any fiscal year or period of that year the goods so marked down are in proportion to current sales, to stock on hand, to mark-downs of corresponding months of the preceding years, or if evidence can be submitted as to market changes which have forced a reduction in retail prices to bring about a parity with the selling price of the same goods which have been purchased or could be purchased at a reduced cost." Governed by these considerations a buyer may take a mark-down at any time and of any amount, provided he can show that such mark-down is not arbitrary but conforms to normal past procedure, or is caused by abnormal current condition, and provided, further, that the goods so marked down are actually offered to the public in the regular way.

Advantages of the retail method.—A comparison of the retail method with other methods used in retail stores shows several decided advantages, not only from the point of view of accounting but of merchandise planning and control. In the first place, it is easier to take physical inventory at selling-price figures, because merchandise tickets have only one price on them. Under the cost method, the ticket not only bears two prices, the cost and retail, but ordinarily the cost price is in code, which necessitates decoding—a process which in most stores has given rise to troublesome error. Most stores have found it poor policy to allow the meaning of the code to be generally known by employees, because of the lack of understanding by the average salespeople of the mark-up on goods. By limiting the decoding to a few, the time for taking inventory is very much longer than under the retail method. Fur-

thermore, the copying of codes by those unfamiliar with their meaning makes the liability of error greater, inasmuch as there is less likelihood of errors being noticed in marking.

Aside from the saving in time and protection against errors, the retail method facilitates the adjustment of value of inventory to market value. For purposes of figuring profits, a merchandise manager is more interested in knowing what his inventory is worth in terms of replacement value than of cost value. It is no longer possible for a merchant to take inventory at cost and then reduce the value by an arbitrary percentage to allow for depreciation. The regulations of the Bureau of Internal Revenue offer a choice of one of two distinct methods for proper valuation of inventories—"cost," or "cost or market," whichever is lower. A merchant using the market method is expected to appraise the market value of each item of merchandise.

The Bureau of Internal Revenue clearly points out that "market" is the current bid price at the date of inventory and, therefore, is a replacement market. In large retail institutions carrying thousands of different articles of merchandise, the appraisal of the separate items even under the most favorable circumstances would be a difficult task. Furthermore, market value frequently does not represent the real value of the goods to the merchant. In the case of seasonable goods, such as women's suits and dresses, carried over from one season to another, the market value at mid-season bears little relation to the actual value of inventory in stock. In these circumstances, it is not only difficult to comply with the government regulations, but the values so derived are not sufficiently accurate for the purpose of figuring merchandise profits.

The retail method of inventory eliminates these estimates or separate appraisals and provides a means of automatically depreciating merchandise to a fair market valuation through the use of mark-down. The retail price or selling price is presumed to represent fairly what the merchant may expect to secure for the goods he has in stock. If an actual inventory is taken at the selling price of goods in a department and this selling price is reduced to cost by applying the complement of purchase mark-up, the resultant figure will reflect any change in market conditions. For example, $4,000 worth of merchandise is bought and placed in stock at $6,000 retail in a depart-

ment with an average purchase mark-up of 33 1/3 per cent. If, before any of these goods are sold, the market declines so that the buyer feels that a mark-down of $500 is advisable, a physical inventory will show $4,000 at cost and $5,500 at retail. Although the merchandise actually cost $4,000, its value has presumably decreased and this change should show on the books. Under the appraisal method, the $4,000 could be decreased to the replacement cost, but by the retail method the value of goods on hand is automatically found by applying 66 2/3 per cent, the complement of the purchase mark-up, to $5,500, giving $3,666.67, the derived cost of the merchandise.

The following quotation [1] gives another example of the advantage of the retail over the cost method:

"Halfway through a selling season, the net sales of a department have amounted to $9,000. At the beginning of the season, the inventory at cost was $4,800, and at retail $6,000; to date purchases at cost have amounted to $12,000, and at retail to $16,000. Mark-downs have been taken to the extent of $1,000 at retail. Figures accumulated by a cost audit of sales show that the cost of merchandise sold to date is $7,000 and the estimated gross margin for the season to date is the difference between the net sales of $9,000 and this cost of merchandise sold, which is $2,000, or 22.2 per cent of sales. If, however, the selling-price method of merchandise accounting is in use, the situation will appear as below.

"Under the cost-audit method the effect of the mark-downs, amounting to $1,000 at retail, on the gross margin was not shown except in so far as these mark-downs may have been instrumental in making the net-sales figure smaller than it otherwise might have been. The major effect of the mark-downs on the gross margin would be shown only when a properly depreciated physical inventory was taken. Meantime, the buyer might assume that his maintained gross margin was well in excess of 20 per cent of sales. By the selling-price method of merchandise accounting, however, the losses which accrue from mark-downs already taken on the goods that remain in stock are at once anticipated, the maintained gross margin shown to be only 15.1 per cent of net sales, and the true condition of the department thus made apparent."

By the aforegoing method a figure is obtained which rep-

[1] Malcolm P. McNair: *"Harvard Business Review,"* October, 1923.

resents the real value of the goods to the merchant. It presumes at all times that proper mark-downs have been taken and the retail price adjusted to market conditions. It is important to point out at this time that the retail system is not intended to bring back to actual cost, but to bring back to value and to value only. Under the cost system, stock or cost books are kept in which the original costs are entered. Unless the cost system definitely provides for changes in the original cost as mark-downs or price changes are made, the buyer never knows at the end of the year to what extent the new cost books show the actual cost value. Consequently, it is a matter of judgment and guesswork in appraising the current cost price. Under the retail method, the buyer definitely establishes the relation between original prices placed on the merchandise and the per cent of reduced prices that he finally gets. By one mathematical operation cost may be derived from retail prices which is much easier than keeping a cost record of thousands of items. For the purpose of figuring profits over a period, a merchant is more interested in the selling price of merchandise than in the cost price. Therefore, a value derived from the retail price will give a better figure than either actual or appraisal cost.

Advantage for merchandise control.—The advantage of the retail method is more important from the viewpoint of merchandise management and control, than as an aid in facilitating a proper valuation of stock at inventory time. For proper merchandise control, it is desirable to have a perpetual inventory as a basis of gauging profits periodically without resorting to a physical inventory. In department stores the gross margin realized by individual departments should be known each month and in some departments each week. It would not be practical to take physical inventory in most cases, and the amount of gross margin can be determined only if the cost of merchandise sold is known. A store using the retail method can figure its gross margin for a period by subtracting cost of sales from sales. Cost of sales is found by subtracting from the amount of merchandise handled the amount of the closing inventory.

In the development of modern merchandising the retail method of inventory has played a very important part. Planning has been dependent to a large decree upon the accuracy

of valuing inventory at both the beginning and the end of a period, so that gross and net profits would be real and not fictitious figures. A store operating on a margin of 4 per cent net profit must adopt some system whereby it is assured that its cost of sales and resultant inventory are accurately valued. If the inventory of merchandise at the end of a period is valued at too high a figure, the profit is overstated. On the other hand, if the inventory is valued at too low a figure, the actual profit is understated. The retail method gives the investment in merchandise as frequently as desired, with the resulting benefit of a definite basis for estimating limits for future purchases, amount of mark-downs, maintained gross margin, and turnover rates, thereby making it possible to plan well in advance and bring merchandise on a more scientific basis. By making a day-to-day comparison of actual results with planned figures, many stores have been able to forecast losses and actually change them into profits.

Disadvantage of retail method of inventory.—The accuracy of the retail method of inventory depends upon a proper departmentalization of merchandise with regard to varying mark-up and turnover rates. The greatest difficulty experienced in the use of this system lies in the fact that no average percentage of purchase mark-up really represents the actual mark-up of goods sold or goods remaining in stock. In the example given below the buyer purchased five $6 hats and six $9 hats, each of which was marked at $12 retail, making a total purchase mark-up of 36.4 per cent. Two of the hats which cost $6 and five of the higher-priced ones were sold.

MILLINERY DEPARTMENT

PURCHASES

Number	*Cost*	*Retail*	*Cost*	*Retail*	*Per Cent Mark-up*
5.........	$6.00	$12.00	$30.00	$60.00	50
6.........	9.00	12.00	54.00	72.00	25
11.........			84.00	132.00	36.4

SALES

Number	*Cost*	*Retail*	*Cost*	*Retail*
2.........	$6.00	$12.00	$12.00	$24.00
5.........	9.00	12.00	45.00	60.00
			57.00	84.00
Stock on hand (actual)..............			27.00	48.00

Retail method — cost of stock 63.6 × 48 = 30.53

The actual cost value of those remaining, therefore, was $27 and the retail value $48. By applying the complement of the purchase mark-up to $48, the derived cost under the retail method is $30.53. In other words, by the retail method the cost value of merchandise on hand is $3.53 more than its actual cost, thus making an increase of $3.53 in the gross margin. The cause of this discrepancy lies in the fact that actually a large part of the merchandise sold bore a mark-up of 25 per cent and that which remained in stock had a mark-up of 50 per cent. It is evident, then, that if the complement of the average percentage of mark-up is applied to the remaining inventory, the derived cost will be higher than the actual cost. If strict accuracy is to be had, the proportion of merchandise bearing a mark-up of 50 per cent to that bearing a mark-up of 25 per cent must be the same in the merchandise remaining in stock at the end of the period as in the total merchandise handled from which the average mark-up was obtained. If this relationship is maintained, the actual cost will be the same as the derived cost, providing no mark-downs have been taken.

Special sales. —The possibility of inaccuracy is increased greatly in stores and departments featuring goods with low mark-ups for special sales events. In the example just cited, if a special lot of hats is placed in stock at a low mark-up they not only lower the average percentage of mark-up for the department, but their lower mark-up will cause them to be sold more quickly, so that at inventory time there is a small proportion of them in stock. The question naturally arises as to whether or not the derived gross margin figure of 36.4 should be used or the real gross margin of 43.8 per cent. This problem is especially significant in the case of merchandise purchased for special events. Goods purchased for special sale purposes and marked less than the regular mark-up of the department may either be charged to the department at the sale price or at the regular price and a mark-down taken. The first method is more consistent and conforms more nearly to the government regulation of a system of averages.

If a department buys a considerable amount of low mark-up goods, the average purchase mark-up will be lowered so as to show the actual relation existing between cost and retail of goods passing through the department. As a general rule, very little of this merchandise remains in the departments, so

that the actual cost value of the inventory is not obtained by using the low average mark-up figure. On the other hand, if the goods are placed in stock with the normal mark-up and then marked down to the special price the department is not conforming to the intentions of the Department of Internal Revenue, that the retail method should be a system of averages. The second method shows a fictitious average mark-up and an exaggerated mark-down which does not in any way reflect the actual operation of the department. Some stores set up separate stock ledgers for low mark-up goods. Such a method is fundamentally the same as creating a subdivision of a department, or a new department.

Mark-ups.—A third difficulty that arises from the use of the retail method is that, on a rising market, inventory may be exaggerated when a store is taking mark-ups. For example, if in a department with merchandise of $6,000 at cost and $9,000 at retail a mark-up of $1,000 is taken, due to a rise in wholesale prices, the retail price would be $10,000. Since the average mark-up of the department is 33 1/3 per cent, the derived cost of inventory is $6,666.67, although the actual cost is only $6,000. The government regulation provides that in arriving at the purchase mark-up percentage it "is proper to include as part of the original sale price the actual increase in the original sales price which has been brought about by changes in market conditions." In the example given above, the mark-up of $1,000 would increase the retail price to $10,000, so that the purchase mark-up would be 40 per cent instead of 33 1/3 per cent.

The question as to whether or not retail inventory is exaggerated depends upon the method of figuring the original purchase mark-up percentage. As stated before, the derived cost of inventory should reflect changes in market conditions. If mark-downs are taken the derived cost of inventory is automatically depreciated, likewise in a rising market the cost of inventory should be appreciated so as to reflect changes in the retail price. On a constant or rising market, if the closing stock has a larger proportion of lower mark-up goods than the average, the resulting valuation figure secured by the retail method will be lower than the actual cost. Because of these inaccuracies a store changing from the cost method to the retail method may show either a paper profit or a loss, depend-

ing upon the period at which the change is made. This discrepancy between real and paper profits exists only at the time of making the change, however, and should not be considered materially disadvantageous in the adoption of the retail method.

A fourth difficulty in the adoption of the retail method lies in the fact that it is not so easily understood by the average buyer as the cost method. A careful process of education is necessary to insure the satisfactory operation of the plan. However, when merchandise has been purchased and placed in stock the important considerations in modern merchandising is toward planning stocks and purchases in terms of what goods will bring at selling price rather than what they cost. For this reason, buyers must think in terms of the retail price and derived cost, even though they still retain the original cost figures. The retail method of inventory is essentially an averaging method and consequently liable to these inaccuracies. This fact has prevented some department stores from adopting it. If, in the operation of the system, it is found that the discrepancies in mark-up or rates of turnover give rise to fallacious derived cost values, the lines should be further divided and subdivision of departments made.

Conclusion.—Although the principles of the retail method are adaptable to most retail businesses, there are lines in which the system should not be used. For instance, in higher-priced jewelry and millinery, the principle of averages is not given a chance to function properly, because of the smaller number of items sold and the differences in mark-up and in rate of turnover. Some stores hesitate to adopt the retail method, because its operation requires an accurate record of all price changes and an exact differentiation between them. A failure to record a mark-down results in an overstatement of assets and a consequent inflation of profits for the period. The accurate recording of price changes should be thought of as an advantage to the selling-price method of merchandise accounting rather than the reverse, since slipshod taking and recording of mark-downs is at present a weakness in the management of many stores.

From the viewpoint of control, the weight of argument appears to favor the use of the selling-price method of merchandise accounting in all types of merchandising business that

can adapt it to their needs. A recent inquiry among more than 500 department and specialty stores reporting figures to the Harvard Bureau of Business Research showed that of 340 firms with sales below $1,000,000 in 1922, 94 were using the selling-price method of merchandise accounting; of 151 firms with sales over $1,000,000 in 1922, 98 were using it; and of 31 specialty stores, 21 were using it. In 1923, 106 firms with sales under $1,000,000 reported they were using the retail method of inventory; of 165 firms with sales over $1,000,000, 118, or 72 per cent, were using this method; and 30 of 41 specialty stores reported they were using the retail method.

Bibliography.

Controllers' Congress: "Standard Method of Accounting for Retail Stores," Vol. I; "Report of Fourth Annual Convention," pp. 15, 44-46, 124-128; "Report of Fifth Annual Convention," p. 47; "Report of Third Annual Convention," pp. 56-61.

McNair, Malcolm P.: "The Retail Method of Inventory," *Harvard Business Review,* October, 1923.

Problems.

1. The H. T. Slater Company operates a specialty store on a cost method of inventory. At the end of the year 1922, Mr. Slater took his inventory at both cost and retail and, during the year 1923, kept account of all mark-ups on purchases. His basis book for 1923 was as follows:

	Cost	*Retail*
Opening inventory	$40,000	$65,000
Purchases	55,000	78,000
Inward express, freight, and cartage....	500	

The sales for the year 1923 were $95,000. After the goods had been marked he had taken subsequent mark-ups (due to incorrect pricing) of $4,000, and subsequent mark-downs of $5,000. At the end of the year 1923, he took a physical inventory at retail figures, which amounted to $37,000.

(*a*) What was the stock shortage for the year 1923?
(*b*) What was the derived cost value and the gross margin percentage of the closing inventory for 1923?

2. The Burton department store had a sales volume of $1,250,000 in 1923. It is operating on the cost method of inventory, but Mr.

Burton, the proprietor, is considering changing to the retail method. In order to get information regarding the retail method he wrote a number of controllers and department-store owners asking them what they considered to be the major advantages and disadvantages of such a system.

The following is a summary of the points brought out in the different letters:

Advantages of Retail Method

1. It is easier to take the physical inventory by the retail method.
2. The profit-making ability of buyers can be checked periodically more easily than under the cost method.
3. If all figures are carried at retail the statistical work will be simplified and the danger of confusion and error lessened.
4. It provides a simple method of arriving at the cost value of inventory.
5. Losses due to mark-downs may be anticipated by this method.

Disadvantages of the Retail Method

1. Not as accurate as the cost method. It is impossible as a rule to get actual cost of inventory.
2. Exaggerates the inventory on a rising market when the store is taking mark-ups.
3. Its success depends on an accurate recording of all price changes, and such control is difficult and expensive.
4. Gives an erroneous cost inventory, if there is a wide difference in the mark-up of the different articles in the department, and if the high and low mark-up goods are not sold in proportion.

(*a*) Are there any additional advantages or disadvantages to the retail method?

(*b*) How should the objections to the retail method be answered?

(*c*) Explain the procedure in adopting the retail method.

3. In the example shown on page 104 the mark-down is $200. Suppose the same net sales had been made and no mark-down had been taken, what would have been the gross margin?

4. The ladies' ready-to-wear department of the Donald's store does an annual business of $40,000. This department is operated on the retail method of inventory, but the buyer is opposed to using it. Last season the purchase mark-up of his department decreased from 35 per cent to 26 per cent, due to special purchases of low mark-up merchandise. He contends that the average mark-up of the goods in stock is as high as it was last year and that, by using the low mark-up figure, his profits will be decreased this year and he will have to take compensating losses next year.

(*a*) Is the buyer correct in his assumption that his low mark-up percentage will inflate his profits for this year?

(*b*) In what way should the special purchases be handled to prevent their distorting the normal percentage mark-up of the department?

5. There are three forms of the retail method in which the "cost" of stock may be derived from the retail value. In each of the examples given on pages 118 and 119 the same figures are used, but it will be noted that the final results vary according to the treatment.

In the first example, the percentage of mark-up (27.37) is obtained on the total purchase to date, which is used to translate the retail value of stock-on-hand figure, after deducting the sales and reductions from the total purchases to date plus opening inventory.

In the second example, the reductions are subtracted from the opening inventory plus purchases before determining the percentage of mark-up (in this case 25.33) to be used in translating retail value of stock.

In the third example, the percentage of mark-up is determined as in the second, but this percentage is used to *cost the sales* and the figures shown in the "stock on hand" column are reduced by the results so obtained. This shows the percentage, representing the difference between cost and selling price as 23.83.

Summarized, the three phases of the method reflect the "cost" of stock on hand, representing $3,329.66 retail value to be

1. $2,418.33, or mark-up of 27.37 per cent.
2. 2,486.26, or mark-up of 25.33 per cent.
3. 2,536.08, or mark-up of 23.83 per cent.

Which of these methods conform most nearly to the rulings of the treasury department governing the retail method of inventory?

6. The following explanation was made by a controller of the way in which his store used the retail method of inventory:

(*a*) Is his calculation correct?
(*b*) Does he conform to the ruling of the Internal Revenue Department?

Beginning with the opening inventory, we have the columns, cost, retail, mark-up, per cent of mark-up, and the complementary per cent of cost arrived at by deducting that mark-up from one hundred per cent. Beginning with an inventory of $1 on which the retail is $1.50, the mark-up 0.50, the consequent per cent of the mark-up 33⅓ and the complementary per cent of cost 66⅔; we add purchases which may happen to be identical with the inventory; freight, express, and cartage inward 2 cents added to the cost; for discount loading, for internal management purposes, 8 cents; additional mark-ups 10 cents added to retail. A line is drawn and at that point the computation of

Example Number 1.

	Purchases						
	Cost	Retail	Per cent	Reductions	Basis		Per cent
Inventory	$1,144.61	$1,619.88	29.34	—	—	—	—
First week	754.50	999.70	24.53	—	—	—	—
Total to date	1,899.11	2,619.58	27.50	—	—	—	—
Second week	1,262.88	1,733.95	27.17	118.50	—	—	—
Total to date	3,161.99	4,353.53	27.37	118.50	—	—	—

	Sales		Stock on Hand		
	Cost	Retail	Cost	Retail	Per cent
Inventory	—	—	—	—	—
First week	—	$466.96	—	—	—
Total to date	—	466.96	$1,560.65	$2,152.62	27.50
Second week	—	438.41	—	—	—
Total to date	—	905.37	2,418.33	3,329.66	27.37

Example Number 2.

	Purchases						
	Cost	Retail	Per cent	Reductions	Basis		Per cent
Inventory	$1,144.61	$1,619.88	—	—	$1,144.61	$1,619.88	29.34
First week	754.50	999.70	—	—	754.50	999.70	27.50
Second week	1,262.88	1,733.95	—	118.50	1,262.88	1,615.45	25.33

	Sales		Stock on Hand		
	Cost	Retail	Cost	Retail	Per cent
Inventory	—	—	—	—	—
First week	—	$466.96	$1,560.65	$2,152.62	27.50
Second week	—	438.41	2,486.26	3,329.66	25.33

Example Number 3.

	Purchases						
	Cost	*Retail*	*Per cent*	*Reductions*	*Basis*		*Per cent*
Inventory	$1,144.61	$1,619.88	29.34	—	—	—	—
First week	754.50	999.70	24.53	—	—	—	—
Total to date	1,899.11	2,619.58	27.50	—	—	—	—
Second week	1,262.88	1,733.95	27.17	$118.50	—	—	—
Total to date	3,161.99	4,353.53	27.37	118.50 (25.33)	—	—	—

	Sales		Stock on Hand		
	Cost	*Retail*	*Cost*	*Retail*	*Per cent*
Inventory	$298.55	—	—	—	—
First week	298.55	$466.96	—	—	—
Total to date	298.55	466.96	$1,600.56	$2,152.62	25.64
Second week	327.36	438.41	—	—	—
Total to date	625.91	905.37	2,536.08	3,329.66	23.83

the basis made. We have thus all the cost elements, all the retail elements, and the mark-up elements entering into that basis computation. At this point we discover that the percentage of mark-up on the cumulative basis is 32⅕ per cent, and the percentage of complementary cost 67⅘ per cent. Now at this point the sales, we will assume, were $1.50, the mark-downs, less whatever mark-down cancellations there were, were 20 cents, the inventory shortage 2 cents, making total retail reductions from the inventory of $1.72. That $1.72 retail reduction is deducted from the retail inventory, plus additions, to leave a resultant retail inventory of $1.38.

Now by the process of the retail inventory method this $1.38 is revalued and we get a cost inventory of $0.93. The cost of sales is arrived at by deducting that cost inventory from the inventory plus additions at cost, leaving a cost of sales of $1.17. The sales were $1.50 and, deducting that $1.17 from $1.50, we get the gross margin of $0.33, or 22 per cent actual maintained mark-up on this transaction.

7. The Howell department store is operated on the cost method of inventory with stock-taking semiannually. All merchandise in this store is charged to the department at prices which, regardless of the terms on which the goods have been purchased, places them on an 8 per cent off, 30-day basis. Each department is charged with the amount by which it fails to meet the required terms on an invoice, and credited for the amount by which it exceeds the required terms. If a bill is net 60 days, it is clear that the buyer has failed to get the discount required, but he has secured for the firm the use of an amount of money equal to the face of the invoice for 30 days longer than was required. In computing the amount of interest to be added to an invoice or to be credited to the department, because of favorable terms on the invoice, the store multiplies the face of the invoice by a computing factor, the size of which measures the variation of the terms secured from the terms required.

For example, in computing the factor to be applied to an invoice bearing the terms 4/30, the store deducts 4 per cent from 100 and divides the result by 92 (100 — 8). If the buyer gets terms of 4/10, the store first places the bill on a net basis and then adds or subtracts a per cent to allow for the interest. In computing the factor for 4/10 invoices, the store deducts 4 per cent from 100, thus getting 96. This is the net cost of the invoice. But in addition to securing only a 4 per cent discount, the buyer got only 10 days' time instead of 30 days required; hence, he failed to get 20 days' time and the interest on the face of the invoice for 20 days at 6 per cent must be added. Hence, to the 96 per cent the store adds .0033 giving .96333 which is divided by 92 per cent to get the factor.

(*a*) What are the specific advantages and disadvantages of "loading" a department with a required discount?

(*b*) What factors should be used in computing the added interest or the extra discount for invoices having the following terms: 6/30, 8/20, 4/20, net 30 days?

Chapter VI

STOCK TURN

It is the function of the merchant to select and carry a reserve supply of merchandise to meet the anticipated demands of his customers. Merchandise investment reaches its highest point of efficiency when the amount of stock carried exactly corresponds with the requirements of the community and offers the facility for purchasing without exhausting the supply. Failure to purchase in a manner that will provide a steady, even flow of merchandise to the customer results in an accumulation of surplus stock which ties up capital and credit and adds to the cost of operation. The extent to which a merchant anticipates the customer's demands is measured by the relation which he maintains between the amount of stock carried and sales.

Determining rate of stock turn.—The disposal and replacement of a given stock of merchandise is called a stock turn. The rate of stock turn is the number of times that the average stock, during the period, is sold and replaced. Unless otherwise stated, this ratio is expressed in terms of a year, that is, 3 means a stock turn three times a year. Most of the confusion in the study of stock-turn figures is due to the lack of properly defining the actual mechanics of finding the rate of stock turn. The only figure which is comparable between stores is a rate of stock turn obtained by using physical units, that is, the number of units sold divided by the average number of units in stock. If the fur department sells eighty fur coats during a period and the average number of coats in stock is twenty, the stock turn would be four. Inasmuch as a complete stock record of physical units is impracticable in most departments, the accepted practice of figuring rate of stock turn is in units of value of merchandise—dollars and cents. The standardized practice in stores using the retail method of inventory is to find stock turn by dividing sales by the average

stock at retail during the period. This figure will show some discrepancy from the rate of stock turn in physical units, but for the purpose of comparison either within the store itself or with other stores, the result is sufficiently accurate. A third method of figuring stock turn is to divide sales at cost by the average net inventory at cost. The relation of the cost and the retail methods of figuring stock turn may best be shown by applying them to the following data, which represent the major operations of a department:

	Cost	*Retail*	*Per cent Mark-up*
Inventory at the beginning of the period	$ 55,000	$ 90,000	
Purchases	70,000	110,000	
Total	$125,000	$200,000	37.5
Net sales		115,000	
Mark-down		10,000	
Closing inventory		75,000	

The average inventory at retail for the department shown above is $82,500 which, divided into $115,000, gives 1.39 as the rate of stock turn figured at retail. In order to determine the stock turn at cost, it is necessary to reduce the inventory and sales figure to cost. By applying, in the above illustration, the complement of the purchase mark-up (100 per cent—37.5 per cent) to the closing book inventory of $75,000, the cost of closing inventory, $46,875, is obtained, which, subtracted from $125,000, the total merchandise handled, gives $78,125, the cost of sales. The average of the opening and closing inventory is, therefore, $50,937.50. By dividing the cost of sales by the average inventory at cost, a rate of stock turn of 1.53 is obtained, which is .14 higher than when figured at retail.

Capital turn.—Retail stores at the present time have not adopted a standard of practice in the method of finding capital turnover. Ordinarily, it means the return through sales of an amount equal to the investment in merchandise. The rate of capital turnover is therefore found by dividing sales by average stock at cost. If a merchant invests $10,000 in merchandise and sells $10,000 of it, he has his original investment back and has made one investment turnover. If the merchandise has a mark-up of 33⅓ per cent he has sold only two-thirds of his stock and has therefore made only two-thirds of a mer-

chandise turnover. There is a direct relationship existing between capital and stock turnover which measures the amount of maintained mark-up within the store or department. For instance, if a store shows a capital turnover of five and a stock turn of four, its average maintained mark-up is 20 per cent. If merchandise is sold at cost, the capital and stock turn would be the same. Some stores use capital turnover instead of stock turnover, because they feel that it is a better index of the efficiency with which capital is used. However, if either figure is used, and the average mark-up known, the other may be ascertained. Capital turnover, as used by some stores, means the total investment in the business divided into sales. If a merchant has $100,000 invested in merchandise, building and equipment, and his annual sales are $500,000, he has a capital or financial turn of five. For the purpose of measuring the effectiveness of merchandising activities, this method of figuring capital turnover should not be used, as it does not indicate the number of times he has turned his merchandise investment.

Average inventory.—The accuracy of the figure representing stock turn is directly dependent upon the method of arriving at the average inventory. Retail stores have not adopted a standard procedure in arriving at this figure which prevents accurate comparison between stores. The Harvard Bureau of Business Research, in its studies of retail store expense, uses an average of the beginning and closing inventory of the fiscal year to find the rate of stock turn. Inasmuch as this method is consistently used, it is possible to make dependable comparisons between the stores reporting to this Bureau. It is fallacious, however, for a store using the average of the inventories for twelve months to compare its rate of stock turn with these figures.

In the 286 stores reporting their monthly stock to the Federal Reserve Board, the average of the twelve monthly inventories is 9 per cent higher than the average of beginning and closing inventory of the year. Thus, if the average of the two inventories were used as a basis for figuring stock turn, it would give a rate about 9 per cent higher than the actual stock turn found by using the average of the twelve months of the year.

To confirm the supposition that rate of stock turn would be lower if the average of the twelve monthly inventory figures

were used, the Harvard Bureau of Business Research worked out a common figure for the 136 firms with sales below $1,000,000 that were able to give monthly inventory figures for 1923. As determined on the basis of twelve monthly inventories, the typical rate of stock turn for these firms was 2.1 as contrasted with the figure 2.4 arrived at by using only the inventories at the beginning and the end of the year. For the firms with sales over $1,000,000, the rate of stock turn was 3, as determined on the basis of twelve monthly inventories, as compared with 3.7 as determined by the other method. The average of the twelve inventories for the smaller stores, as shown in Table 10, is 13 per cent higher than the average of the beginning and closing inventories. In stores with sales over $1,000,000 the average of the twelve inventories is 11 per cent higher, and in the specialty stores 16 per cent higher, than the average of the beginning and ending inventories.

TABLE 10

MONTHLY INVENTORIES FOR 1923 *

(*Average monthly inventory = 100*)

	Department Stores		Specialty Stores	All † Department Stores
	Under $1,000,000 (75)	*Over* $1,000,000 (163)	(41)	(286)
January	84	86	81	89
February	93	93	94	95
March	100	101	102	103
April	102	104	106	103
May	102	102	101	100
June	97	96	95	95
July	94	93	89	99
August	100	98	96	97
September	110	107	110	105
October	113	112	120	109
November	112	114	115	112
December	93	94	91	94

* Bureau of Business Research, Harvard University, *Bulletin No. 36.*
† United States Department of Commerce, *Survey of Current Business.*

It can readily be seen from these figures that to get an accurate rate of stock turn for the year, either the average of the twelve inventories should be used or a representative month chosen. Associations, in which turnover figures are

interchanged, have generally adopted the standard practice of using the average of the inventories as of the first of each month and the last of the year, making a total of 13 inventory figures. For the store as a whole, this gives a sufficiently accurate average stock for the purpose of comparison.

The number of inventories which should be used to get an accurate average for an individual department depends directly upon the rapidity with which goods move. In most lines the stock at the first or end of each month gives a sufficiently accurate figure; however, in rapid-moving lines, such as millinery, it is necessary to have a weekly stock figure. Most stores keep a current book inventory figure which is used for purposes of figuring stock turn by weeks or months. It is necessary to depreciate this book inventory currently by the allowance for inventory shrinkage as determined by past experience.

The following figures representing the sales and stocks in the women's suit department of a specialty store serve to indicate the variation in rate of stock turn which results from using different bases for finding the average stock. The stock is of the first of the month:

	Stock	*Sales*	*Ratio*	*Rate of Stock Turn for Year*
February	$ 3,215	$ 1,276	.4	4.8
March	8,221	6,554	.8	9.6
April	15,972	9,022	.56	6.7
May	12,089	4,933	.4	4.8
June	6,712	798	.12	1.4
July	4,524	1,362	.3	3.6
July 31	2,800			
Average stock	$ 7,647	$23,936	3.1	6.2

In the above illustration the stock turn for the six-months' period is 3.1, as determined by using the average of the seven monthly inventories. If only the opening and closing inventories were used ($3,215 and $2,800), the average stock would be $3,007 and the stock turn 7.9 for the six months' period.

Rate of stock turn in different classes of stores.—Because of the nature of the merchandise handled it is evident that stock should be turned much more rapidly in some classes of stores than in others. In the butcher shop, fruit store, and cigar store, the stock should be turned every few days. On

the other hand, the merchants who must carry large assortments of goods to supply the needs of their customers can turn their stocks only a few times a year. Hardware, jewelry, and shoe dealers come in this class. The average stock turn for department stores reporting to the Harvard Bureau of Business Research with sales under $1,000,000 was 2.4 in 1922 and the same in 1923. In this group of 340 stores, 19 turned their stock more than five times and 21 less than 1.4 times in 1922. During 1923, 98 stores, of 403 reporting, failed to turn their stock as often as two times a year. On the other hand, 38 stores succeeded in obtaining a rate of turnover of four times or more. For department stores with sales over $1,000,000 the common figure for stock turn was 3.5 in 1922 and 3.7 in 1923. In the former year 13 stores turned their stock more than five times, as compared with 11 that had a stock turn of less than 2.2, and in the latter year 15 stores turned their stock more than five times, while only one store failed to turn its stock as often as two times a year. In specialty stores the common figures for stock turn for 1922 were 4.3 and 5.9 in 1923. Inasmuch as these stock turn figures are computed on the basis of an average of the inventory at the beginning and end of the year, they are higher than the actual stock turn computed on the basis of an average of the twelve monthly inventories.

The average rate of stock turn in basement stores is usually higher than that of upstairs stores, because of the merchandise policy. In one basement in which an automatic mark-down system is used the rate of stock turn is 17 times a year. In this store at the end of 12 selling days a mark-down of 25 per cent of the original retail price is taken; after 18 selling days a 50 per cent reduction is taken; after 24 days a 75 per cent reduction; and after 30 selling days the goods are given away, so that no merchandise can remain in forward stock more than thirty selling days.

The common rate of stock turn in shoe stores and hardware stores is about 2 times a year, whereas retail grocery stores have a common figure of 8. General merchandise stores have a common figure of 2½ times a year, and jewelry stores approximately 1. Although there is a wide variation in the average rate of stock turn in the different classes of stores, the variation in different stores within the same class is even wider.

In grocery stores it varies from 2 to 26 times a year and in general merchandise stores from 1 to 14. These variations can be accounted for only by difference in efficiency in operation, local conditions, and merchandising policies.

Stock turn by departments.—The variations in the rates of stock turn are even wider among different lines of merchandise than among the stores as a whole. In an investigation of representative stores made by the Controllers' Congress of the National Retail Dry Goods Association, the rate of stock turn in millinery varied from 23.3 to 1; women's dresses from 18 to 1.4; women's coats from 17.5 to 1.4; house furnishings from 9.5 to less than 1; and women's shoes from 6.7 to .8. Without a careful study of the conditions which gave rise to these various rates of stock turn it would be impossible to draw conclusions. Because of the lack of standardization in the classification of merchandise and the number of inventories included in getting average stock, it is impossible to make comparison between independent stores. However, in a group of associated stores that have adopted standard classification of merchandise and methods of obtaining the rate of stock turn, the comparisons are more accurate. For instance, in one association of stores a monthly comparison of stock, sales, and rate of stock turn is made. The stock is of the first of the month and the rate of stock turn for the season is found by averaging the six monthly inventories and dividing the average into the sales for the six months. These stores not only make a comparison between rates of stock turn for the season as a whole, but for each month. If the stock turn for one store is out of line with the others, a check-up can be made for each individual month and the ratio adjusted. This is one of the major advantages of an interchange of figures which are based upon similar conditions. Unless the same lines are included in departments and the same number of inventories used to find the average stock, it is impossible to make an accurate comparison among stores of rates of stock turn.

Importance of stock turn.—The importance of stock turn in merchandising operations varies not only with different departments, but with different seasons and phases of the business cycle. In a study of stock turn two things must be clearly differentiated: (1) the rate of stock turn as a direct cause of

increased net profits; and (2) the rate of stock turn as an index of business efficiency. It is necessary first to determine what effect increasing the rate of stock turn should have upon gross margin and net profits and then see whether or not the effect is shown by actual figures. Even though a high rate of stock turn usually accompanies low operating expenses and high net profits, neither need necessarily be the direct result of a high stock turn. In order, therefore, properly to appreciate the effect of the rate of turnover on merchandising operation, it is necessary to examine each element affected by a change in the rates.

Interest, insurance, and taxes.—The amount of interest, insurance, and taxes which a merchant pays on merchandise is in direct proportion to the average amount of stock carried. In a department with sales of $10,000 and two stock turns, the expense for these items will be just twice as much as in a department with the same sales and four stock turns, inasmuch as the first department has an average stock of $5,000 and the second an average of $2,500. Whether the money invested in merchandise is owned or borrowed the expense for interest is the same, although there may not actually be an expenditure. Although the expense percentages for interest, insurance, and taxes on buildings, equipment and fixtures do not bear a direct relationship to rate of stock turn, there is a tendency for them to decrease, because space, equipment and fixtures are more efficiently used. If a merchant gets $100,000 sales from an average stock of $20,000, it is possible for him to use less space, display fixtures, and equipment, than if he had an average stock of $25,000 for the same sales.

An examination of the actual expense figures in Tables 11, 12, 13, 14, and 15 shows that interest, insurance, and taxes decrease as the rate of stock turn increases. In department stores with sales under $1,000,000 in 1922, interest is 3.7 per cent for stores with a stock turn of less than two times and 1.9 per cent for stores with a stock turn of more than 2.8 times. Insurance varied from .7 per cent to .4 per cent and taxes from .8 to .6 in the same group of stores. In department stores with sales over $1,000,000, the interest is 2.4 per cent for firms with a stock turn less than 3 times and 1.7 per cent for those with stock turns of more than 4 times. Likewise,

insurance decreased from .4 per cent to .3 per cent and taxes from .7 per cent to .4 per cent. About the same relationship was shown in 1923 between these expenses and rates of stock turn. In retail shoe stores, interest charges decreased from 4.4 per cent with a stock turn of less than 1.4 per cent to 2 per cent for stores with stock turns over 2.2 times.

TABLE 11

PERCENTAGE OF EXPENSES, GROSS MARGIN, AND NET PROFIT IN 1923, IN DEPARTMENT STORES WITH NET SALES OF $1,000,000 AND OVER ACCORDING TO RATE OF STOCK TURN *

Net Sales = 100 Per Cent.

	Stock Turn Less than 3 Times	*3–3.9 Times*	*4 Times and Over*
Number of firms	38	62	61
Salaries and wages	16.5	15.4	14.7
Rentals	3.2	2.7	2.6
Advertising	2.9	2.9	3.0
Interest	2.4	1.9	1.4
Traveling	0.4	0.4	0.4
Losses from bad debts	0.2	0.2	0.2
Total expense	30.5	28.4	27.1
Gross margin	33.1	32.1	31.3
Net profit	2.6	3.7	4.2

* Bureau of Business Research, Harvard University, *Bulletin No. 44.*

TABLE 12

PERCENTAGE OF EXPENSES, GROSS MARGIN, AND NET PROFIT IN 1923 IN DEPARTMENT STORES WITH NET SALES LESS THAN $1,000,000 ACCORDING TO RATE OF STOCK TURN *

Net Sales = 100 Per Cent.

	Stock Turn Less than 2 Times	*2–2.7 Times*	*2.8 Times and Over*
Number of firms	98	159	141
Salaries and wages	14.5	14.3	13.9
Rentals	2.4	2.3	2.1
Advertising	1.9	2.0	2.0
Interest	3.4	2.6	1.9
Traveling	0.3	0.35	0.3
Losses from bad debts	0.3	0.4	0.3
Total expense	27.5	26.3	25.6
Gross margin	28.0	28.3	28.3
Net profit	0.5	2.0	2.7

* Bureau of Business Research, Harvard University, *Bulletin No. 44.*

TABLE 13

PERCENTAGE OF MAJOR EXPENSES, GROSS MARGIN, AND NET PROFIT IN 1923, IN RETAIL SHOE STORES ACCORDING TO RATE OF STOCK TURN *

Net Sales = 100 Per Cent.

	Stock Turn Less than 1.4 Times	*1.4–1.7 Times*	*1.8–2.1 Times*	*2.2 Times and Over*
Number of firms	98	107	98	183
Salaries and wages	16.2	15.2	14.1	13.9
Advertising	2.1	2.2	2.1	2.3
Rent	3.5	3.9	3.2	3.4
Total interest	4.3	3.1	2.4	1.8
Total expense	30.6	28.9	25.9	25.7
Gross margin	28.5	28.9	28.8	29.7
Net profit or loss......Loss	2.1	0.0	2.9	4.0

* Bureau of Business Research, Harvard University, *Bulletin No. 43.*

TABLE 14

PERCENTAGE OF MAJOR EXPENSES, GROSS MARGIN, AND NET PROFIT IN 1923, IN RETAIL GROCERY STORES ACCORDING TO RATE OF STOCK TURN *

Net Sales = 100 Per Cent.

	Stock Turn Less than 7 Times	*7–11.9 Times*	*12 Times and Over*
Number of Stores	104	198	161
Salaries and wages	10.9	10.5	10.5
Advertising	0.3	0.2	0.3
Rent	1.7	1.3	1.1
Total interest	1.5	1.0	0.7
Total expense	19.0	17.0	16.7
Gross margin	19.9	19.0	18.8
Net profit	0.9	2.0	2.1

* Bureau of Business Research, Harvard University, *Bulletin No. 41.*

In jewelry stores which turned their stock less than .7 times in 1922, the expense for interest and taxes was 8.4 and 1.5, respectively, whereas in stores that turned their stock more than once a year these expenses were only 3.9 and 1.1, respectively. In all other stores in which a detailed study has been made there is found a direct relation between interest, insurance, and taxes, and rate of stock turn.

Rental.—The percentage of expenses for rentals also bears a direct relationship to rate of stock turn. Inasmuch as this expense is usually charged to a department on the basis of the

TABLE 15

OPERATING EXPENSES, GROSS MARGIN, AND NET PROFIT OR LOSS FOR 170 RETAIL JEWELRY STORES IN 1922, ACCORDING TO RATE OF STOCK TURN *

Merchandising and Repairing Figures Separated—Net Sales = 100 Per Cent.

	Stock Turn Less than 0.7 Times	*Stock Turn 0.7–0.9 Times*	*Stock Turn 1.0 Times and Over*
Number of firms	45	61	64
	Per cent	*Per cent*	*Per cent*
Merchandise departments:			
Wages of sales force	11.6	12.6	9.8
Advertising	2.9	3.5	2.8
Buying, management, and office salaries	6.4	5.2	6.4
Rent	5.5	4.7	4.3
Taxes	1.5	1.3	1.1
Total interest	8.4	6.2	3.9
Total fixed charges and upkeep	18.8	15.3	11.9
Total expense	44.5	40.7	36.2
Gross margin	39.9	38.8	37.6
Net profit or loss	Loss 4.6	Loss 1.9	Profit 1.4

* Bureau of Business Research, Harvard University, *Bulletin No. 38,* "Operating Expenses in Retail Jewelry Stores in 1922," p. 50.

number of square feet occupied, the amount of rental charge which an item of merchandise must bear is in direct proportion to the amount of space it occupies and the time it is in stock. Shelf and storage room is a definite part of the expense of doing business and that portion which is devoted to slow-selling merchandise is wasted. A merchant may decrease the percentage of rental expense by devoting a larger portion of the total space to selling or by decreasing the length of time in which an item remains in stock. The rent which a retailer can afford to pay per square foot is in direct proportion to the potential customers which pass or can be attracted to the location. One merchant in the shopping center of New York City pays a yearly rental of $125 per square foot, whereas some retailers in smaller towns pay only $1 per square foot.

The percentage of expense for rent depends upon the degree with which space is utilized rather than the amount of rent paid. Some merchants will use the appeal, "Our rents are low, therefore our prices are low." This appeal may attract customers and create traffic, thereby making low rents for a short time, but competition will soon adjust the rentals to the

increased customer traffic. On the other hand, through a long-time lease, a merchant may obtain a low rental figure which will materially decrease his percentage of rental expense. As a general rule, a low rental expense percentage is the result of efficient use of space and a rapid rate of stock turn. In the stores reporting to the Bureau of Business Research of Harvard University, the percentage of rental expense tends to decrease as the rate of stock turn increases. In department stores with sales under $1,000,000, the common figure for rentals in 1923 was 2.4 per cent for stores with stock turn less than 2 times a year, and 2.1 per cent for stores with stock turns of more than 2.8 times a year. For stores with more than $1,000,000 sales the rental expense was 3.2 for those with stock turn less than 3 times, and 2.6 for stores with stock turn more than 4 times a year. In other types of stores rentals show about the same variation.

Contradictory evidence in regard to rent appears in the following table on operating expenses in department stores in 1921 according to the rate of stock turn. Here the highest rent expense appears in the high-stock turn group.

TABLE 16

OPERATING EXPENSES IN DEPARTMENT STORES IN 1921,* ACCORDING TO RATE OF STOCK TURN

Net Sales = 100 Per Cent.

	Stock Turn Less than 2.5 Times	*2.5–3.4 Times*	*3.5 Times and Over*
Number of firms	95	94	111
	Per cent	*Per cent*	*Per cent*
Salaries and wages	16.2	15.4	14.7
Rentals	2.3	2.4	2.5
Advertising	2.2	2.4	2.5
Interest	3.0	2.2	1.8
Total expense	28.5	27.9	27.1

* Bureau of Business Research, Harvard University, *Bulletin No. 35*, "Operating Expenses in Department Stores in 1921."

Salary and wages.—Salary and wage expense tends to decrease with an increase in the rate of stock turn. In department stores with sales under $1,000,000, the common figure in 1923 was 14.5 per cent for those with a stock turn under 2

times a year and 13.9 for those with a stock turn of more than 2.8 times. In department stores with sales over $1,000,000, the common figure for those with stock turn under 3 times a year was 16.5; and for stores with stock turn over 4 times, the common figure was 14.7 per cent. These variations were about the same in 1921 and in 1922, both for department stores and for other types of stores. The effect of a rapid rate of stock turn on such fixed charges as interest, insurance, and taxes is readily understandable, but the lower ratio of salaries and wages for stores with relatively higher rates of stock turn presumably may be taken as an indication that in these stores good management was exercised in effecting other economies, such as a decrease in mark-downs and other unprofitable operations.

Other advantages.—Mark-downs caused by soiled and shopworn merchandise are greatly decreased by increasing the rate of stock turn. The stocks are also fresher and more desirable, which adds to the prestige and reputation of a department and a store. Salespeople are more enthusiastic about selling new goods and new styles. As a general rule, they are more familiar with new goods than with stock which has been in the department for a longer time. Not only does sales resistance to older stock increase with time, but sales effort decreases, due to loss of enthusiasm and confidence in the goods on the part of salespeople. Furthermore, a department that maintains a small stock and rapid turnover is more often "open-to-buy" new merchandise and to take advantage of special offerings. It is also in better position to take advantage of price changes, or to buy special merchandise to meet competitive mark-down sales. More frequent purchases keep buyers in closer contact with manufacturers and better informed concerning market conditions. This contact with the manufacturers not only gives a store a better standing in the market, but enables buyers to study the sources of competitors, get market tips, and make more accurate forecasts of style and price tendencies.

Stock turn and the business cycle.—In so far as there is an element of risk due to a decline in prices, a rapid rate of stock turn is advantageous. The importance of selling merchandise quickly varies directly with the trend of prices. During 1918 and 1919 when prices were increased, most stores

with a slow stock turn showed better net profit than stores with a more rapid stock turn, whereas, during 1920 and 1921, the reverse was true. The average percentage of net profit in jewelry stores in 1919 and 1920 was lower in the group of stores having a high rate of stock turn than in the low stock turn groups, although the former group had lower operating expenses. It is evident that the higher profit was due to the wider gross margin which the low stock turn group was able to maintain, because of the appreciation in the retail value of stock. Similar conditions were shown in the retail shoe trade during 1919, but in both 1920 and 1921 better showing was made in the high-stock-turn groups.[1]

Part of the profit realized by stores in 1918 and 1919 was an investment profit due to an appreciation in the value of merchandise on hand. This profit should be clearly differentiated from the profit to which a merchant is entitled as a result of his merchandising operations. If, over a complete business cycle, a store maintains the same rate of stock turn, the profit which is realized by the appreciation of merchandise, when prices are rising, will be offset by the depreciation of merchandise when prices are falling. In addition, the store will have an increased loss due to the cost of re-marking the merchandise both on the rising and falling market. The most advantageous condition is that in which a store maintains a slower rate of stock turn on a rising market and then anticipates the break in prices sufficiently in advance to decrease its stock and maintain a hand-to-mouth-buying policy during the recession in prices.

Total expenses.—The principle is well established that a relatively rapid rate of stock turn is ordinarily accompanied by a relatively low rate of total operating expenses. In department stores with sales volume under $1,000,000, in 1923 the common figure for total expense was 27.5 per cent in stores with a stock turn less than 2 times a year and 25.6 per cent in stores with a stock turn more than 2.8 times. In stores with sales over $1,000,000 for the same year the total expense for those with stock turn under 3 times was 30.5 per cent and 27.1 per cent for stores with stock turn over 4 times. About the same variations were found in 1921 and 1922. In

[1] Malcolm P. McNair: "The Significance of Stock Turn in Retail and Wholesale Merchandising," *Harvard Business Review,* October, 1922.

shoe stores the total expense was 30.1 per cent and 26 per cent in stores with stock turns of less than 1.4 times and more than 2.2 times, respectively. About the same variation in ratios is found in other types of retail stores as shown by Tables 13, 14, and 15.

Relation of net profit to rate of stock turn.—The economies in operation due to a relatively rapid rate of stock turn tend to increase the ratio of net profit in all types of stores in which dependable studies have been made. In the group of 403 department stores with sales under $1,000,000, which reported to the Harvard Bureau of Business Research in 1923, those having a stock turn less than 2 times realized a common net-profit figure of .5 per cent of their net sales, whereas those with a stock turn of more than 2.8 had a net profit of 2.7 per cent of net sales. Likewise, in stores with sales over $1,000,000 the net profit was 2.6 per cent for those turning their stocks less than 3 times and 4.2 per cent for those with stock turn more than 4. About the same variation was shown in the rate of net profit in 1921 and 1922. In 1922 the common figure for 107 shoe stores with a stock turn less than 1.4 times was 3.4 per cent net loss, and the common figure for net profit for 119 firms with a stock turn of 2.2 and over was 3.9 per cent. Grocery stores with a stock turn less than 8 in 1922 showed a net profit of .6 per cent, whereas those with a stock turn of 12 times and over had a common figure of 2.3 per cent for net profit. In jewelry stores with a stock turn of less than .7 times in 1922, the net loss was 4.3 per cent. Those with a stock turn of 1 time and over had a common figure of 1.4 per cent net profit.

In any discussion of stock turn and its effect upon profits, a clear distinction should be made between profits on investment and profits on net sales. The standardized practice under the retail method of inventory is to figure all expenses, gross mark-up, and profits on net sales. If merchandise costing $60 is sold for $100 with expenses of $37, the gross margin is $40, or 40 per cent, the expenses 37 per cent, and the net profit $3, or 3 per cent. Investors, stockholders, and owners of capital in general are, in most cases, more interested in net profit as a percentage of investment, rather than as profit on sales. In the case stated above, the net profit on merchandise investment would be $3 on $60, or 5 per cent. It makes little

difference for purposes of comparison whether merchandise investment or volume of sales is employed, so long as all percentages are kept on the same basis, because of the fixed relationship existing between percentages on sales and percentages on cost of merchandise. This relationship is best shown as

$$\frac{\text{Percentage on sales}}{\text{100 per cent — percentage of gross margin on sales}} = \text{Percentage on cost.}$$

A common illustration of the effect of stock turn on profits is found in the following:

Using the original $1 investment

Stock turn—3 times		*Stock Turn—5 times*	
Retail	$1.50	Retail	$1.50
Cost	1.00	Cost	1.00
Gross margin	.50	Gross margin	.50
Expenses	.40	Expenses	.40
Net profit	.10	Net profit	.10
Stock turn	3	Stock turn	5
Season Net profit	.30	Season Net profit	.50

From an illustration of this kind, much confusion arises, due to the failure to point out the relation existing between net profit on sales and net profit on investment. The total net profit on investment increases with the number of stock turns, so the net profit on each turn multiplied by the number of turns will give total net profit. However, in basing net profit on sales it makes no difference how many times the stock turns, the ratio will be the same. In the illustration given above, for three stock turns, the total net profit for the season is 30 cents, and the total sales $4.50, giving a net profit of 1.5 per cent. For five stock turns the total net profit is 50 cents and the total sale $7.50 or 1.5 per cent. If the stock were turned 20 times the net profit would remain the same, except for such changes as would be brought about by a lowering of the expense figure due to more efficient use of capital, space, and personnel. Such statements as "five stock turns per annum at a gross profit of ten per cent are equivalent to one stock turn yearly at a gross profit of fifty per cent" give rise to very serious errors. By failing to state correctly the basis of comparison used, such statements are not only meaningless, but may lead to dangerous assumptions concerning the real effect

of rate of stock turn upon gross margin, net profit, and selling expenses.

Another set of assumptions that needs to be carefully examined is that expenses may be divided into two groups, one of which will remain unchanged in dollars and cents, no matter what the volume of sales may be, so long as that volume is obtained by increasing the rate of stock turn. At the same time it is assumed that other expenses will vary directly with the volume of sales. With this assumption a ratio chart is constructed showing the net profit obtained at different rates of stock turn. For instance, a merchant makes an investment of $100 in merchandise which is sold at $150; he again invests this $100 in merchandise and sells it at $150, repeating this operation four times. His purchases cost a total of $400 and his total sales are $600, resulting in a gross margin of $200, or $50 for each turn. Consequently, for each additional turn, his gross margin will be increased $50, while certain of his expenses, such as rent, interest, insurance, and taxes, will remain constant. If this increase in sales volume has been obtained without decreasing the gross margin or increasing other expenses, such as advertising or returned merchandise, the merchant will presumably decrease his operating expenses and consequently increase his net profit.

A common method of illustrating the increase in net profit due to an increase in the number of stock turns is shown in Figure 11.[2] In this figure are shown two graphs, series A-1, A-2, A-3, A-4, and series B-1, B-2, B-3, B-4.

Each of the columns in series A represents sales amounting to $100,000, but the number of turnovers increases from 1 in A-1 to 8 in A-4, and it will be observed that with each increase in turnover the stock investment as well as the interest is cut in two, while the amount of profit increases. Series B shows uniform stock investments and costs of interest throughout, while the amount of profit increases with the number of turnovers. Differently expressed, series A proves the decreased investment needed to perform a given amount of business, while series B proves the increased business and profits which accrue to the same investment upon a multiplied turnover.

It is presumed in series B that the increase in sales is made

[2] Domestic Distribution Department of the United States Chamber of Commerce.

without any increase in interest on stock investment or fixed expense. The total interest and fixed expenses, however, would presumably increase, due to the added equipment necessary to maintain a higher sales volume.

Causes of slow rate of stock turn.—A number of causes may legitimately slow up the rate of merchandise turnover, the most important of which is service to customer in offering a wide range of stocks in complete lines. The prestige of a retail store is greatly increased by the general understanding

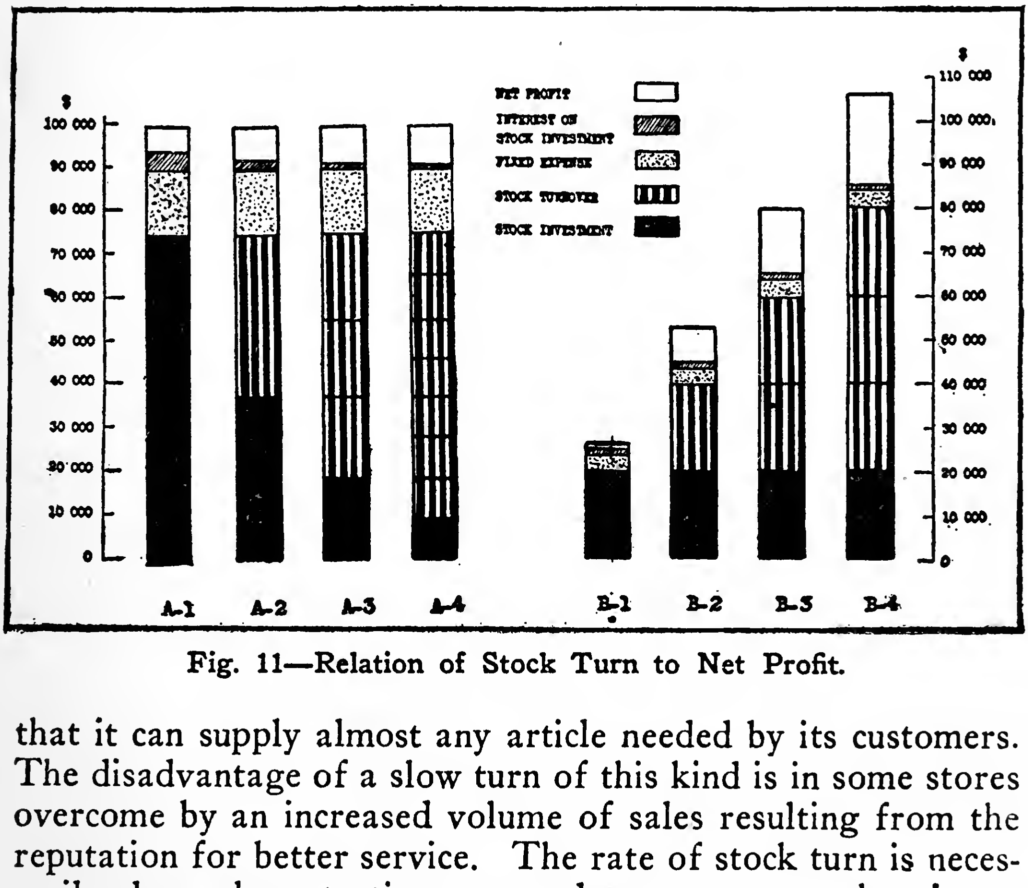

Fig. 11—Relation of Stock Turn to Net Profit.

that it can supply almost any article needed by its customers. The disadvantage of a slow turn of this kind is in some stores overcome by an increased volume of sales resulting from the reputation for better service. The rate of stock turn is necessarily slow when starting a new department, or when introducing new elements into a department. If, in an infant's department with a stock turn of six, a complete line of infant's furniture is introduced, the rate of stock turn for the department as a whole would necessarily be lower until customers become thoroughly accustomed to the fact that the new lines are carried.

An analysis of the turnover of a department is not complete until the causes of slow turnover are ascertained. In most cases this necessitates a careful subdivision of stock

within the department to see just what particular lines are moving. A shoe retailer, for example, in 1923, reached the conclusion that he should secure a more rapid rate of stock turn. He had turned his stock 2.8 times in 1922, a rate somewhat above the average, but still less than that secured by several other shoe merchants. For purposes of analysis he decided to classify his stock into four groups: (1) rapid-moving styles, (2) average-moving styles, (3) slow-moving styles, and (4) non-moving styles. The classification showed the results given in the tabulation below.

Classification	*Number of Styles*	*Number of Pairs*	*Annual Rate of Stock Turn*
1. Rapid-moving styles	5	345	16
2. Average-moving styles	40	2,200	6.3
3. Slow-moving styles	105	7,050	1.8
4. Non-moving styles	32	950	...
	182	10,635	Average 2.8

On the basis of this information, plans were put into effect for disposing of the merchandise in the last two groups. Within a few months the total number of pairs of shoes in stock was reduced from 10,635 to 5,640 pairs, and the number of styles from 182 to 84. In the group of non-moving styles the number of styles was reduced from 32 to 8 and the number of pairs of shoes from 950 to 351. In the group of slow-moving styles the number of styles carried was cut from 105 to 40 and the number of pairs from 7,050 to 2,551. As a result of this change in policy, the annual rate of stock turn rose from 2.8 times to 4.3 times, and the net profit was substantially increased.[3]

Location.—Slow stock turn sometimes results from the merchant's location. As a general principle the farther he is from manufacturing or wholesale centers, the slower his turnover will be. This is due to the need of advance buying in large quantities in order to decrease transportation charges and buyer's traveling expenses. How far stock turn should be allowed to decrease, because of distance from the market, is determined by a direct comparison between the losses due to slow turnover, and the increasing costs of more frequent purchases. There is a tendency for department stores located

[3] Copeland, Melvin T.: "Principles of Merchandising," p. 306.

near the central market to have a slightly higher rate of stock turn than those located at a distance, as shown by Table 17.

TABLE 17

Stock Turn in Department Stores According to Geographic Location

	Group I		Group II		Group III		Group IV		Group V *
	1922	1923	1922	1923	1922	1923	1922	1923	1923
Under $1,000,000	2.7	2.7	2.3	2.4	2.3	2.4	2.2	2.3	2.3
Over $1,000,000	3.7	3.7	4.0	3.9	3.6	3.8	2.8	3.2	

Group I	Group II
Districts	Districts
No. 1. Boston	No. 4. Cleveland
" 2. New York	" 7. Chicago
" 3. Philadelphia	" 8. St. Louis
Group III	**Group IV**
Districts	Districts
No. 5. Richmond	No. 9. Minneapolis
" 6. Atlanta	" 10. Kansas City
" 11. Dallas	" 12. San Francisco

* In 1923, District No. 12 was reported separately for stores under $1,000,000.

The stores in the Boston, New York, and Philadelphia Federal Reserve Districts with sales more than $1,000,000 had a stock turn of 3.7 in 1922, and those in the Cleveland, Chicago, and St. Louis district a stock turn of 4, whereas those located in the Minneapolis, Kansas City, and San Francisco districts had a stock turn of only 2.8 times.[4]

In 1923 the stock turn in the San Francisco, Minneapolis, and Kansas City districts was 3.2, whereas in the Boston, New York, and Philadelphia districts the stock turn was 3.7. Stores with sales under $1,000,000 showed about the same variation in rate of stock turn in the different districts. Stores that maintain a representative in the central market, as a general rule, are able to maintain a higher rate of stock turn than those without representation. The advantages accruing to a more rapid rate of stock turn counterbalance, to a large degree, the cost of a market representation. In jewelry stores the rate of stock turn for the San Francisco Federal Reserve District was .7 in 1923, as compared with approximately 1 for the eastern districts. Similar variations were shown in grocery stores for 1923, but in the shoe trade the effect of locations was not so apparent. Although the rates of stock turn in

[4] Bureau of Business Research, Harvard University, *Bulletins Nos. 37, 44.*

general have a tendency in some types of stores to decrease with distance from the manufacturing centers, an analysis of individual cases seems to indicate that the rate of stock turn is primarily a matter of management rather than of location. Inasmuch as the central market varies with the different lines of merchandise, it is impossible to draw dependable conclusions by using the store as a whole. A study of this kind may best be made by using individual lines of merchandise.

Size of store.—As a general rule, the larger stores maintain a higher rate of stock turn than the smaller stores. This is shown by Table 18, in which a comparison is made between

TABLE 18 *

RELATION BETWEEN SIZE OF STORE AND RATE OF STOCK TURN IN 1923

Size	*Number of Stores*	*Total Expense*	*Net Profit*	*Rate of Stock Turn*
Department Stores:		*Per cent*	*Per cent*	*Per cent*
Less than $ 250,000	188	25.4	1.4	2.1
250,000– 499,000	121	26.6	2.3	2.5
500,000– 999,000	94	27.6	2.3	2.9
1,000,000–3,999,000	119	28.5	3.2	3.5
4,000,000–9,999,000	25	28.2	4.1	4.1
10,000,000 and over.........	19	27.8	5.6	4.5
Shoe Stores:				
Net sales less than				
$30,000	94	27.8 Loss	0.7	1.4
30,000– 49,000	115	25.5	1.9	1.8
50,000– 99,000	133	26.7	1.8	2.0
100,000–249,000	101	27.5	3.1	2.2
Over 250,000	56	32.0	2.8	2.6
Jewelry Stores:				
Less than $20,000	106	37.7 Loss	0.2	0.8
$20,000– 49,000	88	35.7	3.1	0.9
50,000 and over..........	96	35.7	3.0	1.1

* Bureau of Business Research, Harvard University, *Bulletins Nos. 43, 44, and 47.*

stores doing more than $1,000,000 and those doing less than $1,000,000. The rate of stock turn also tends to increase with an increase in sales in grocery, jewelry, and shoe stores, as shown in the table above. The higher rate of stock turn in the larger store is due, first, to more highly developed systems of stock planning and purchase control. In the second place, the larger stores, because of their volume of purchases,

are able to maintain closer contact with the central market and thus make relatively smaller purchases. A third reason for a higher stock turn in larger stores, especially in department stores, is that in a large number of lines a complete assortment must be maintained so that the minimum stock in the smaller store is relatively higher than that of the larger store.

Duplication of stock.—The rate of stock turn is influenced directly by conflicting price lines, styles, and brands of merchandise. For instance, if a store carries two or more brands of black hosiery in which a complete range of prices and sizes is maintained, it will presumably have a slower rate of stock turn than a store carrying only one good brand. In merchandising for a rapid rate of stock turn, it is inevitable that a few sales occasionally will be lost. A merchant who carries a stock of every item for which he may have an occasional demand will necessarily have a heavy stock and consequently a slow rate of stock turn. The losses due to heavy carrying charges and risk from mark-down may more than counterbalance the gains that result from occasional sales.

On the other hand, there is a tendency on the part of some merchants to overemphasize the advantage of a rapid rate of stock turn. There are two danger points in stock turn—one when it is too low and the other when it is too high. It is well recognized that each customer that cannot be served constitutes an expense to the store. An investment is made by the merchant in rent, advertising, and fixtures to attract customers to the merchandise. There should usually be a direct relationship between the investment and the number of customers attracted. Each customer who fails to purchase because of incomplete lines or service constitutes a loss to the store. In staple lines of merchandise in which the risk of style changes and obsolescence is at a minimum, it is possible for a merchant to determine with a reasonable degree of accuracy the most advantageous relationship between stock and sales. It is possible for him to determine how many items he must sell per day, week, or month in order to pay for the carrying charges on a particular line. For instance, an analysis of past sales should show whether a particular brand of collar has shown a profit. In determining whether or not a line of merchandise should be discarded, the buyer should consider

whether or not he had in stock similar articles which have the same general characteristics and which may reasonably be substituted.

In staple lines of merchandise where the risk is at a minimum, it is possible for the buyer to bring about a parity between the savings resulting from larger orders, because of discounts, terms, transportation charges, and receiving costs, and the expenses of carrying stock over a longer period. This is a problem for each individual line of merchandise.

Planning stock turn.—The rate of stock turn is a resultant figure, depending upon the relation between sales and stock for a given period. The amount of stock required to produce a planned volume of sales in a department depends upon the time of the season, the nature of the merchandise, the distance from the source, the time element of delivery, and the completeness of the lines carried. Because of these factors the rate of stock turn varies widely in different stores and departments or lines of merchandise. It varies also in the different seasons and months of the year. The planned yearly rate of stock turn, therefore, is the resultant of a series of planned monthly and departmental ratios, each of which directly affects the total figure.

In some stores the rate of turnover is planned by the season and by months which, divided into planned sales for the period, give the amount of stock that must be carried. In other stores the practice is to plan the amount of stock by completeness of lines which is necessary to produce the planned sales, thus making the rate of turnover a resultant figure. If the planned ratio between stock and sales does not give the desired rate of stock turn, adjustments are made either in the planned stock or planned sales figures. The common practice is to plan the rate of stock turn by departments for the season as a whole and then to adjust the stock and sales by months, to give the planned season turnover. The rate of stock turn in a store or department is compared with the best information which is available. For example, if a store finds that its rate of stock turn in the millinery department has been 7, the average for the Federal Reserve district, 14, and the high record 22, the first step is an analysis of the relation of stock to sales during each month of the period, in order to determine what ratio of stock to sales at the beginning of each month will pro-

duce the desired rate of stock turn. In most departments it is not only difficult but undesirable for a store to maintain a constant ratio of stock to sales at all times of the season. But a ratio may be worked out allowing a department its greatest investment in stock when public demand for full-price merchandise is the highest and its least proportionate investment as the demand decreases.

The following table shows the planned figures in a millinery department for the spring season in a specialty store. This store is a member of an association of stores which exchanges monthly stock and sales figures:

	Feb.	*March*	*April*	*May*	*June*	*July*	*Total*
Rate of stock turn..	1	1½	2	1½	1½	1½	9
Planned sales	5,000	12,000	11,000	7,500	6,000	4,500	46,000
Planned stock first of month	5,000	8,000	5,500	5,000	4,000	3,000	

The planned turnover for the season was arrived at in this store by a comparison of attainment of the most successful departments in its Federal Reserve district, its own past experience, and the experience of member stores in the association. It is generally recognized by merchants that in every department there is a minimum rate of stock turn, below which a loss will be shown. On the other hand, it is recognized that an undue limitation of merchandise investment to get a high rate of stock turn results in a decrease in actual and potential sales volume and a consequent loss in institutional prestige.

Increasing the rate of stock turn.—The rate of stock turn may be increased by increasing the volume of sales without a corresponding increase in the average stock, or by maintaining the same sales on a smaller average stock. The first step, therefore, in maintaining the most advantageous ratio between stock and sales, is careful planning, so that the department will have the wanted merchandise at the right time. The merchandise plan should provide for the elimination of unprofitable price lines and a concentration on the lines which are moving and are in constant demand by the public. The second step is a control over purchases, so that the stock may be kept as nearly as possible to a point of maximum representation and minimum investment. The third factor which must be considered in increasing the rate of stock turn is the judi-

cious pricing of merchandise, that is, marking the goods at the lowest price consistent with safety and reasonable profit. Another factor is good store publicity and merchandise advertising, calling attention to the completeness of stock during peak seasons and prices during dull periods. A fifth and final step in increasing the rate of stock turn is the maintenance of an efficient selling organization, so that the store will get maximum sales from the potential customer traffic.

The most important factors in turnover rates are the things which the rates themselves measure. The rate of stock turn is a definite measure of the efficiency in procuring merchandise. The efficiency with which merchandise is procured depends upon the buyer's knowledge of the customers' demands, the degree of success with which merchandise stocks are planned in advance, and the distribution of merchandise investment between departments, sections of departments, and lines of merchandise. The efficiency of the buying organization is dependent, in a large degree, upon the knowledge of available resources, their development to suit the needs of the store as determined by the customers' demands, and the maintenance of proper business relations between them. Buying efficiency depends upon the ability to select from the best resources the merchandise that will be salable, and in a somewhat less important degree upon the efficiency of the transportation method used to secure the quickest and least expensive transportation from the vendor to the stores. The rate of turnover depends to a large degree upon the time element of delivery. If a buyer can replace the merchandise which he sells daily he can turn his stock 300 times a year. The elapsed time between the delivery of merchandise into the store and the time it is sold to the customer is the real element in turnover.

There are three steps involved in maintaining an advantageous rate of stock turn. (1) Plan the total amount of stock that should be carried at different periods in order to provide for estimated sales. (2) Distribute and control the purchases [5] so as to have a selection of goods that will be salable. (3) Promote the sale of merchandise through effective advertising, display, and salesmanship, so as to dispose

[5] An effective control of purchases requires a current stock and sales record for determining the range of sizes, price lines, and styles which may be sold within the normal stock-turn period.

expeditiously of merchandise on the shelves. These three steps present the real problems of merchandising which will be treated separately in the following chapters.

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Problems.

1. The following data represent the operation of a department during the year 1923:

	Cost	*Retail*
Inventory beginning	$12,000	$16,000
Purchases	40,000	54,000
Sales		$52,000
Mark-downs		4,000

The buyer in this department determined the rate of stock turn by dividing the sales by the average stock at retail at the beginning and end of the period. The controller found the rate of stock turn by dividing the cost of sales by the average stock at cost. The buyer could not understand why the two methods did not give the same rate of stock turn.

(*a*) Should there be any discrepancy in the figures as determined by the two methods, and if so, how much?
(*b*) What is the capital turn in this department?

2. The rate of stock turn in a representative group of department stores in 1923 was 4 and the rate of capital turn 5. During the same year the rate of stock turn in a group of grocery stores was 7 and the capital turn 8.

(*a*) Which of the groups maintained the highest percentage of gross margin?

(*b*) If the rate of capital turn is 3 and the gross margin 33⅓ per cent, what is the rate of stock turn?

3. The sales of the Meade specialty store in 1923 were $1,424,000 and the average of the stock at retail for January and December was $200,000.

Assuming that the monthly inventories varied in accordance with the figures shown in Table 10, what would be the rate of stock turn if the twelve monthly inventories were used?

4. The two stores represented by the statements shown below are located within two blocks of each other in the same city. Each of these stores has been in existence for over 40 years. During 1920 the store with the slow rate of stock turn lost about $40,000 while the other made nearly $15,000. During 1918 and 1919 the store with the slower rate of stock turn made approximately $40,000 more than the store with the fast rate of stock turn. During the last five years each of these stores has made about the same net profit for the entire period. Neither of these stores, however, included in its cost of operation the interest on money in use in the business, with the exception of actual bills payable to the bank. The sales of the store with fast rate of stock turn in 1923 was approximately $1,100,000 and that of the other store $1,000,000. The former store caters to a high class of trade and the latter carries popular-priced merchandise.

STORE WITH SLOW RATE OF STOCK TURN

Assets	
Cash on hand and in bank	$ 35,351.68
Notes receivable	2,238.44
Accounts receivable	107,913.33
Stock on hand	278,189.26
Liberty bonds	16,946.64
Fixtures	19,864.81
	$460,504.16

Liabilities	
Accounts payable (for merchandise)	$ 26,108.58
Bills payable (borrowed money)	38,415.00
Due stockholders and employees	1,496.20
Capital stock	175,000.00
Surplus	219,484.38
	$460,504.16

STORE WITH FAST RATE OF STOCK TURN

Assets	
Cash on hand and in bank	$ 6,758.90
Notes receivable	2,227.90
Accounts receivable	43,073.42
Stock on hand	135,102.23
Investments	2,223.99
Fixtures	32,607.40
	$221,993.84

Liabilities	
Accounts payable (for merchandise)	$ 62,587.29
Bills payable (borrowed money)	41,000.00
Due stockholders and employees	2,272.63
Capital stock	85,000.00
Surplus	31,133.92
	$221,993.84

(*a*) Assuming that accounts receivable and stock on hand represent the only difference in the amount of money invested in the two businesses, what is the difference in the interest charges (interest at 6 per cent)?

(*b*) Which of these two businesses seem to be in the better financial condition?

5. In explaining to a group of buyers the advantages of an increase in the rates of turnover, a merchandise manager used the following example:

Suppose we take a merchant having sales of $30,000, a gross profit of 30 per cent (in which are included operating expenses of $7,500), and an average inventory of $5,000 at selling prices. Let us see how many turnovers he has, and then how much his net profit amounts to.

Inventory		$ 5,000
Sales		30,000
	$5,000/	$30,000/ 6 turnovers
		30,000
Sales		$30,000
Gross profit		30%
		$ 9,000
Operating expense		7,500
Net profit		$ 1,500

With six turnovers he has a net profit of $1,500. Now let us see what would be the result of having seven turnovers.

Inventory	$ 5,000
Turnovers	7
Sales	$35,000
Gross profit	30%
Gross profit	$10,500
Operating expense	7,500
Net profit	$ 3,000

With seven turnovers his profits are doubled. With eight turnovers his net profit would jump to $4,500. Of course, we are assuming that his operating expenses remain the same in each case. To increase the rate of turnover from six to seven, and from seven to eight, there would naturally be increases in operating expenses. There might be more advertising necessary, or a slight reduction in prices, or something of the sort. But even if the increases amounted to seven or eight hundred dollars each time, there would still remain a substantial increase in net profits.

(*a*) Has the merchandise manager made logical assumptions regarding the increase in net profits due to increasing the rate of stock turn?

(*b*) What expense percentages should be directly affected by an increase in the rate of stock turn? According to reports of the Harvard Bureau of Business Research, what expense ratios actually decrease with an increase in the rate of stock turn?

(*c*) What is the relationship between rate of stock turn and size of store?

(*d*) Does the location of the store seem to affect the rate of stock turn?

6. "At the present time there is unquestionably a tendency on the part of some merchants to overemphasize the advantage of a rapid stock turn. There are two danger points in stock turn—one when it is too low, and the other when it is too high."

(*a*) What do you consider the point of maximum advantage resulting from stock turn? (This discussion should indicate the specific relation which a buyer should aim to maintain between sales and stocks.)

(*b*) Outline the points you would emphasize in advising a new buyer how to arrive at the most advantageous turnover.

(*c*) How do you account for the fact that the subject of stock turn has been given so much attention during the past three or four years?

7. The following data represent the operation of a department during the year 1923:

	Cost	*Retail*
Gross sales		$30,460
Mark-downs		2,080
Returns and allowances to customers....		3,100
Inventory, December 31, 1922...........	$ 9,400	13,300
Purchases—net	28,300	42,400
Inward freight and express charges.....	900	
Addition mark-ups		600
Inventory shortage		860
Total expenses		5,864

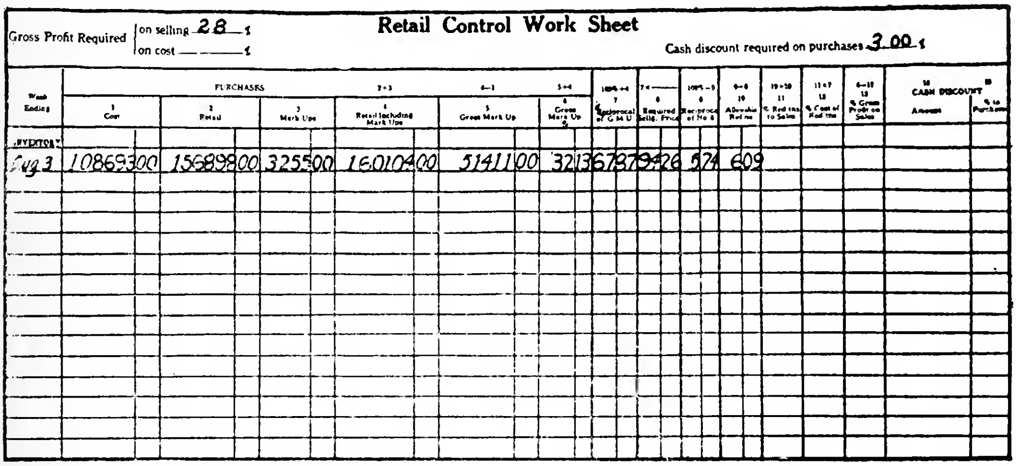
(*a*) What was the percentage of net profit?

(*b*) What was the rate of stock turn figured at retail, using the book inventory at the beginning and close of the period?

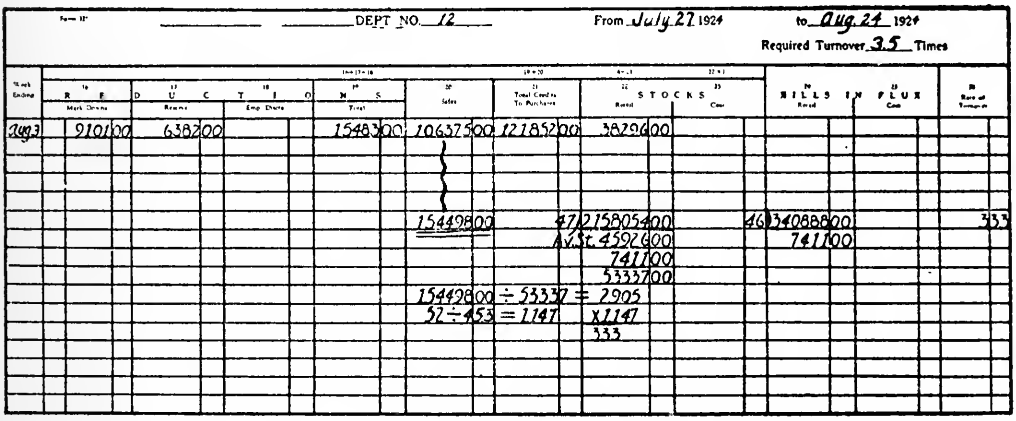
(*c*) What was the rate of stock turn figured at cost, of inventory at the beginning of the period and the derived cost of book inventory at the close of the period? What is the cause of the discrepancy in the rates of stock turn as figured at cost and at retail?

(*d*) What is the capital turnover for this department?

8. The Marcy department store is located in a large metropolitan area in the East. This store does an annual business of approximately $20,000,000. It is a cash store and emphasizes in its advertising a low mark-up and a rapid rate of stock turn. Because of its narrow margin of net profit the Marcy store has emphasized the definite planning of


Retail Control Work Sheet
Gross Profit Required on selling 28 % on cost ——— %
Cash discount required on purchases 3.00 %
Week Ending | PURCHASES: 1 Cost | 2 Retail | 3 Mark Ups | 4 Retail Including Mark Ups | 5 Gross Mark Up | 6 Gross Mark Up % | 7 Reciprocal of G M U | 8 Required Sellg. Price | 9 Reciprocal of No. 8 | 10 Allowable Red'ns | 11 % Red'ns to Sales | 12 % Cost of Red'ns | 13 % Gross Profit on Sales | 14 CASH DISCOUNT Amount | 15 % to Purchases
INVENTORY
Aug 3 10869300 15689800 325500 16010400 5141100 3213 6787 9426 574 609

A


DEPT NO. 12 From July 27 1924 to Aug. 24 1924
Required Turnover 3.5 Times
Week Ending | REDUCTIONS: 16 Mark Downs | 17 Rem'ns | 18 Emp. Disc'ts | 19 Total | 20 Sales | 21 Total Credit to Purchases | STOCKS: 22 Retail | 23 Cost | BILLS IN FLUX: 24 Retail | 25 Cost | 26 Rate of Turnover
Aug 3 910100 638200 1548300 10637500 12185200 3829600
15449800 47) 215805400 46) 340888800 333
Av. St. 4592600 741100
741100
5333700
15449800 ÷ 53337 = 2905
52 ÷ 453 = 1147 X1147
333

B

Fig. 12—Retail Control Work Sheet.
A. First Half of Work Sheet.
B. Second Half of Work Sheet.

its merchandising activities. In a recent talk before a group of students, Mr. Blake, a member of the controller's office, explained the Retail Control Work Sheet, Figure 12, which is used by this store. By making entries in the first seven columns he showed the method of arriving at the gross mark-up percentage. The required selling price, column 8, is arrived at by dividing column 7 by 72 per cent (100 per cent — 28

per cent required gross margin). In order to explain the method of arriving at the rate of stock turn, Mr. Blake made an entry for columns 20, 22, and 24 to represent the totals of these columns at the end of the 46th week. By dividing the total stocks by the number of weeks the average stock for the period is arrived at. Inasmuch as the stock at the beginning of the period is included, there were actually 47 different stocks included in the total of column 22. The total of column 24 is divided by 46, because there were only 46 entries made for "bills in flux" during this period. Therefore, $53,337 is the average stock from which sales of $154,498 were made. By dividing the sales by the average stock the stock turn for the period is found to be 2.905.

In reducing this stock turn to the basis of a year, it was first necessary to eliminate the holiday which resulted in an actual selling time of 45.3 weeks. By dividing 52 by 45.3 and multiplying the result by 2.905 the rate of stock turn of 3.33 is arrived at for the year. Mr. Blake explained that "bills in flux" represented the merchandise which was in the store, but whose invoice had not been passed through the accounts-payable department. When asked to prove that the plan would give the required gross margin of 28 per cent, Mr. Blake made the following calculation: 6.09 $\times$ 32.13 per cent $=$ 1.96 per cent. By adding 1.96 to 32.13 and then subtracting 6.09 the result is 28.

(*a*) Does Mr. Blake's explanation make clear the method of arriving at the different figures shown in the columns?

(*b*) Is the method of arriving at column 10 correct?

(*c*) What changes should be made in the wording of the explanations shown at the heads of columns 7, 8, and 11?

(*d*) Is the method of arriving at the figures in column 13 correct?

Chapter VII

PHYSICAL INVENTORY AND SLOW-SELLING STOCK

The amount of stock which should be on hand in a department or store at any particular time is called the book inventory. This figure is arrived at currently by subtracting net sales and mark-downs from inventory at the beginning plus additions. In order to check the accuracy of this book or perpetual inventory figure, it is necessary to take a physical count of the actual merchandise on hand. Theoretically, the book and the physical inventory should be the same. Any deviation between the book figure and the actual figure is called a stock shortage or overage, as the case may be. A stock shortage or overage may be due to an error in arriving at the book figure, a failure to get an accurate count, or an actual shortage of merchandise due to theft by employees or customers. In any case, the physical count is the basis upon which gross margin and net profits are figured. It is important, therefore, to get an accurate count of the stock on hand, (1) that profits may be real or actual; and (2) that there may be a proper check upon the statistical book figure.

The price that appears on the merchandise which is on the selling floor should represent its retail market value. In actual practice, however, it is necessary for a buyer to go through the stock previous to inventory taking and make a thorough inspection of all items, taking such mark-downs and making such adjustments as will bring the market price in line with what may reasonably be expected to be its sale value. This inspection usually results in the discovery of mismated items, soiled and shopworn merchandise in drawers and fixtures, and a large amount of merchandise which has been overlooked in the different departments. If a store is operating under the retail method of inventory, the adjustments in the retail price of merchandise automatically reflect in the derived cost price.

If the inventory is taken at cost, however, the cost price of the merchandise must be adjusted to cost or market, whichever is lower, before the physical count is taken. A physical inventory is of little value if it is not an accurate statement showing the financial standing of the store or department, the condition of a stock as to age, and the relative investment in different lines.

Methods of Taking Physical Inventory.

The method of taking physical inventory differs with the different types of stores and with the policies of the individual management. There is, however, an inventory procedure in the larger retail stores which has become somewhat standardized. The need for more careful accounting and merchandise planning has resulted in the common practice in larger stores of taking a semiannual inventory, the date of which, in most stores, is either about December 31 and June 30, or January 31 and July 31. These dates have been chosen because in most departments they represent the in-between season, at which time the stocks should be small. The success of a physical count as to accuracy and the time required depends to a large degree upon advance planning and organization.

Inaccuracies in the taking of inventories are due to three major causes: (1) failure to list accurately all merchandise within and without the department; (2) failure to draw a distinct line between merchandise charged to the department and that within the store but not charged; and (3) failure to get a cross-sectional audit of merchandise charged out of the department such as approval, C.O.D, and stock repair. The first step, therefore, in the preparation for stock taking is physically to separate the merchandise within the department, to insure all divisions being represented by a stock sheet. The next step is to provide a system whereby all sheets are charged to the department in such a way that they may be audited, and finally to prepare a chart of the physical divisions of the department so that, by checking the sheets against the physical divisions, any duplications in listing the merchandise may be detected. In order to facilitate the issuing of stock sheets, some stores require the head of each department to draw a rough sketch, showing the position and the number of fixtures

in the department with notations for horizontal and vertical sections in each fixture. To insure that all merchandise is taken without duplication the buyer or head of the department should check off on the chart or sketch of the department each section or division as the inventory is complete. The following instructions, issued previous to stock taking by one of the larger stores in New York City, make clear the general principles of an accurate plan for taking stock:

Instructions to department managers for stock taking.—The semiannual stock taking occurs on the evening of Saturday, February 2, 1924. As usual, the stock is to be taken on the official inventory sheets, which are to be procured from the office of the controller. The week ending February 2nd will be a "no purchase week," in order that the receiving room, the controller, and you may bring all the work up to date, and with your helpful coöperation start the new season with a clean record.

Stock repairs.—No stock repairs or stock returns will be received by the receiving department between Monday, January 21, and Monday, February 4, in order that the receiving department and the office of the controller may properly clear out all stock-repair and stock-return records, before the semiannual inventory. May we point out to you the great importance of accurately listing your repairs, especially those that are out of the building. The accounts-payable division of the controller's office will hand you a list of all stock repairs which are open from your department. Repairs must be listed by you, and it is suggested that you kindly procure the above list before February 2, to be checked against your record. If you know that any of these are returned and will be taken in stock, make a separate report to the office of the controller, so he will be guided accordingly.

Stock analysis.—A copy of your stock analysis has been sent to you. Past experience has taught us that these analyses are rarely ever complete. They fail to cover everything listed on your inventory. Kindly add to this analysis any item which may be required by your existing stock, making all corrections necessary, and return it to the office of the controller. If there are no corrections to be made, please return the analysis at once, signifying that fact over your signature. In regard to

your physical inventory, the custom of omitting the classification number is too prevalent. Your stock is analyzed by number only. Failure to enter the correct number may result in an improper analysis or classification of your stock, causing it to be placed under the "Miscellaneous" heading. To insure accuracy, please enter both number and classification in the space provided at the top of the inventory page. It is important that you assign separate classification numbers to all "imported merchandise" to distinguish it from domestic stock of the same character.

Season letters.—Particular stress should be laid upon the proper entry of season letters. The custom of omitting the proper letter tends toward placing your stock under old season letters, resulting in an erroneous season stock analysis. Therefore, will you carefully instruct all concerned that the proper season letter must be placed in the season column? This applies to every sheet in your inventory and no exceptions should be allowed. Department managers will see that under no circumstances are separate lists made preliminary to or during stock taking. The official inventory sheets only are to be used. The expense of errors in copying from one sheet to another is too great to be compared with the small cost of the inventory sheets. Please remember that stock sheets are cheaper than errors, and that errors necessitate the retaking of inventories. You will be held accountable for each sheet charged to your department. Therefore, see that none are destroyed or lost. All sheets must be returned to the office, whether used or unused, and arranged in numerical order.

Reserve stock.—Inventory sheets will be distributed to department managers as early as may reasonably be desired, for the proper taking of reserve stock, but no forward stock may be listed before the bell rings on the evening of Saturday, February 2, 1924. Sheets on which are listed stock in reserve, or anywhere outside of the space devoted to selling, must be marked accordingly. This means that merchandise in warehouses should be so indicated on the inventory sheets.

Deduction sheet.—Whenever merchandise in reserve is taken to the counter after having been listed, a deduction sheet must be made up. When the necessity arises for deduction sheets, they should be specially requested at the office of the controller by the department managers, and, when the in-

ventory is complete, signed by them and turned in with stock sheets. No sheet may be used for deduction unless stamped "deduction sheet" by the office.

Plan.—At least one week before inventory each department manager shall submit to the controller's office a rough, front-view sketch of each fixture in his department. Each fixture shall bear a number. Each vertical division in each fixture shall also bear a number, and each horizontal division shall be designated by a letter. On the day preceding the inventory, stock sheets shall be properly placed in the fixtures, and properly accounted for on the tally card provided. It is necessary that a stock sheet be placed in each subdivision of each fixture, whether each contains merchandise or not. Errors often occur because sheets are not properly placed in each fixture, and in consequence the department managers cannot be sure all sheets are collected at the conclusion of the inventory, nor that the inventory is complete. Plans must be submitted at least three days before inventory date, and must be approved by the office of the controller before any inventory sheets are distributed.

Tally card.—A tally card will be found at the back of each pad of stock sheets. This tally card must carry a complete record of the whereabouts of each stock sheet before any listing is done. Care should be used in assigning a sufficient number of sheets to each subdivision, so that when the inventory is complete the sheets may be taken up in consecutive order. Whenever it is necessary to place an additional sheet in a subdivision, note the number of the additional sheet in the column provided for remarks against the number of the sheet so supplemented. The number of the original sheet should be noted on the tally card against the supplemental number. When inventory is complete, and all sheets taken up, the sheets must be arranged in their numerical order, fastened together, and backed by the tally card. On each tally card must be indicated the number of the last sheet used.

First seven sheets.—The first of the inventory sheets in each department should be marked "Repairs" and all stock merchandise out of the department for repairs at the time the inventory is taken must be listed thereon. The second sheet must be marked "Window Dresser"; the third sheet, "Foreign Office Samples"; the fourth, "Merchandise in Advertising

Office"; the fifth, "Merchandise Held in the Executive Office"; the sixth, "Merchandise in the Department Manager's Own Office"; the seventh, "Merchandise in Comparison Department"; and on each of these sheets must be listed the merchandise out of the department for the various reasons given. If there is not merchandise outside the department, these seven sheets must nevertheless be made out and marked "none" and signed by the department manager. If for any reason any stock is in any other place outside the department, separate sheets must be made out in each case.

Last sheet used.—When the inventory is complete, the department managers, or their assistants, shall personally gather the sheets, see that there is a sheet from each section or subdivision, and, upon scrutinizing each sheet, determine whether each section has been properly inventoried. A section here and there should be recounted to verify the original count, and the department manager or his assistant should initial such recounted sheets. The department manager must personally sign the last sheet of each pad, and when some sheets of a pad are not used, the department manager must sign the last sheet used and state that it is the "last sheet used."

Completed inventory.—After "last sheet used" has been signed, care should be taken to see that all sheets are in numerical order and none missing. Pads should be fastened with clips provided for that purpose and arranged in the proper numerical order (lowest number on top).

Invoices.—As a precautionary measure, all invoices received between January 28 and February 2 will be stamped by the receiving department, "Old Stock—New Stock," and department managers must cross out the words "Old Stock" if the merchandise is not taken in the inventory, and if the merchandise covered by such invoices has been taken in the inventory the words "New Stock" must be crossed out. Carelessness with invoices often causes more re-takes than carelessness in taking the actual inventory. "Watch your invoices."

"Old Stock" is stock marked "N" or older.

"New Stock" is stock marked "P."

Prior stock.—The monthly taking of prior stock will be continued. "J and Older" stock will be taken on the last Saturday of each month. When the semiannual inventory has

been figured the sheets will be returned to department managers to enable them to list on special prior stock sheets all "J and Older" stock. It is, therefore, necessary for department managers to see that each item bearing a "J or Older" tag is so located that the monthly prior stock inventory may be taken with dispatch.

Forms used.—A store operating under the retail method of inventory needs only the information called for in Figure 13, which gives the department number, classification of merchandise, description of item, quantity, price, season letter, and location within the department. The season letter repre-

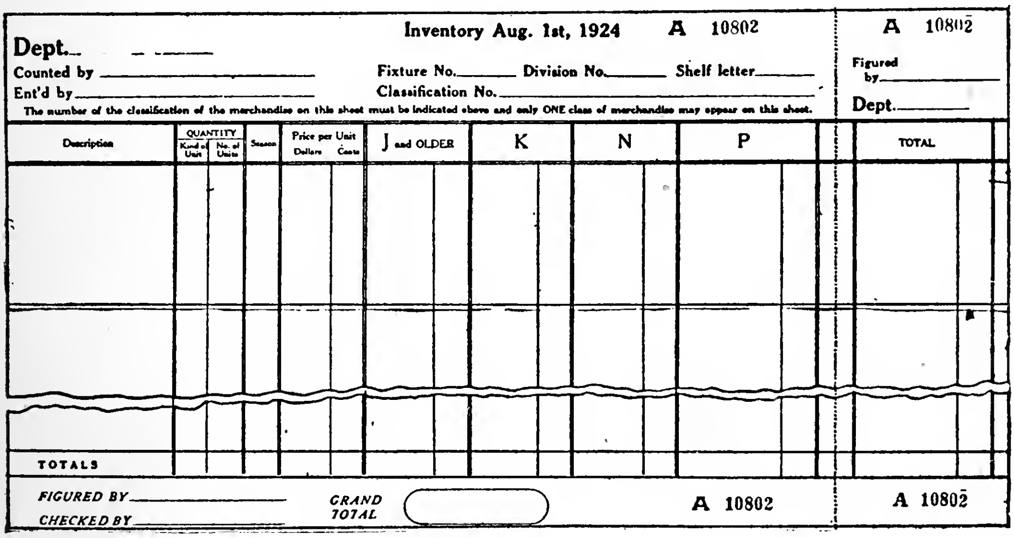


Fig. 13—Inventory Sheet.

sents the period in which the merchandise was placed in stock. It may represent a six-months or a three-months period. In some departments it is necessary to indicate the month or week in which items are placed in stock. Thus, K2 means that the merchandise was placed in stock during the second month of K season. The classification of merchandise by season letter should indicate the relative amount of merchandise which has been in stock for the different periods of time as summarized in Figure 14 and also form a basis for the operation of a slow-selling system. The recording of the location of merchandise within the department is important as a basis for re-check in case of error. It also facilitates the location of merchandise which is entered on the slow-selling sheet.

Physical count.—It is the practice to take the entire inventory in as short a period as possible, although in department stores separate departments may be taken as units scheduled over as long a period as desired. It is felt, however, that inasmuch as a physical inventory is a cross-sectional view of the store a more comparable picture is presented if the condition of stock at a particular date is obtained. The time required to take the inventory depends upon the details of the preliminary plans and the method used in making the actual count. If the plans are so drawn up that all employees assist

SUMMARY OF DEPT.________

Inventory of Aug. 1st, 1924

Sheets No.________To________Incl.

SHEET No.	J and Older		K		N		P		TOTAL	
TOTALS										

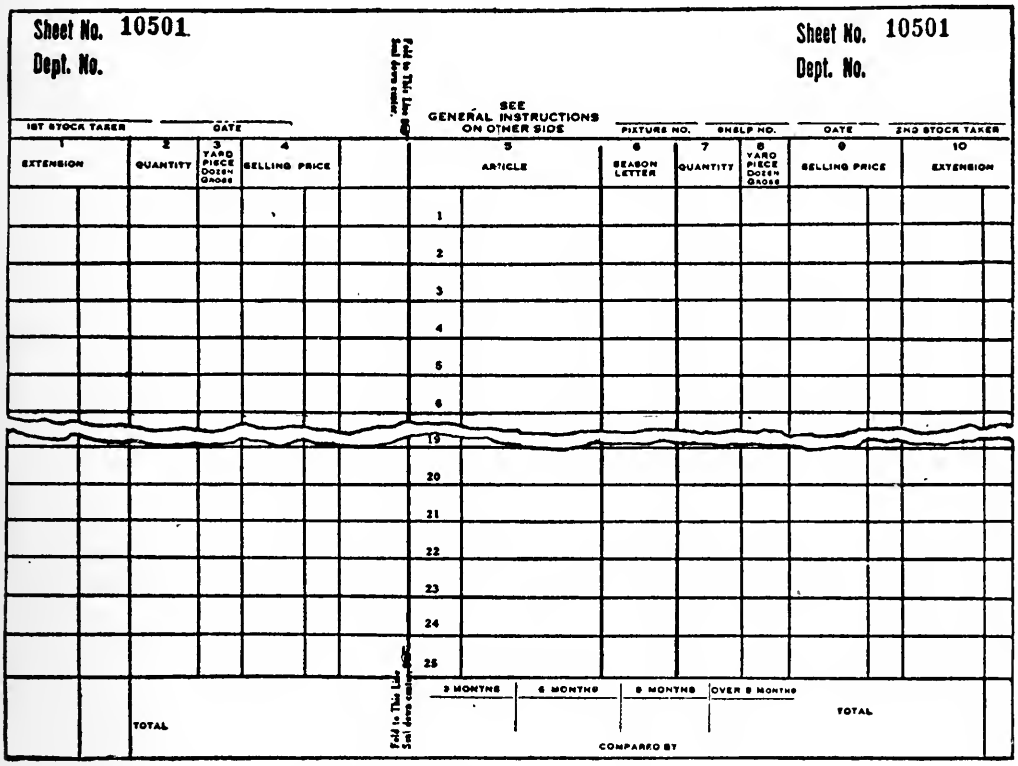
ENTERED BY________
ADDED BY________ CORRECTED BY________

Fig. 14—Summary of Inventory According to Age.

in the physical check, the period will be reduced to a minimum. If, however, an inventory squad or special group of employees take the inventory the time necessarily will be longer.

The average employee in the retail store has sufficient capability to check the items of merchandise either in his own, or in some other, department. The accuracy of the results depends to a large degree upon the manner in which the work is scheduled and the actual counting done. The regular personnel of the store or department is more familiar with the stock as to its location and can give a better description when listing it on the inventory sheet. On the other hand, the sales-

people of a department may defeat the very purpose for which the inventory is taken by arbitrarily inflating the figures to cover up any thefts by employees or customers of which they are aware. Some stores feel that the check should be made by salespeople from other departments, so that any inaccuracies would be unbiased rather than biased because of the opportunity given to salespeople to adjust the figures by reason of a personal interest. The weight of opinion, however, seems to be that to bring new salespeople into a department results in



Sheet No. 10501
Dept. No.

Sheet No. 10501
Dept. No.

1ST STOCK TAKER — DATE — SEE GENERAL INSTRUCTIONS ON OTHER SIDE — FIXTURE NO. — SHELF NO. — DATE — 2ND STOCK TAKER

Fold to This Line Seal down center

1 EXTENSION	2 QUANTITY	3 YARD PIECE DOZEN GROSS	4 SELLING PRICE			5 ARTICLE	6 SEASON LETTER	7 QUANTITY	8 YARD PIECE DOZEN GROSS	9 SELLING PRICE	10 EXTENSION
					1						
					2						
					3						
					4						
					5						
					6						
					19						
					20						
					21						
					22						
					23						
					24						
					25						

TOTAL — Fold to This Line Seal down center — 3 MONTHS — 6 MONTHS — 9 MONTHS — OVER 9 MONTHS — TOTAL — COMPARED BY

Fig. 15—Report of Stock-taker.

more confusion and chances for error than to allow the listing to be done by those who are familiar with the stock. The chances of errors due to collusion on the part of salespeople is less than error due to unfamiliarity with stock. It must be emphasized that the accuracy of results in either case will depend upon the method of supervision and the system used to check the listings. These methods may be divided into two major headings—those in which a blind check is made and those in which only one listing is made. The general principle of the blind check is brought out in the use of the form shown

in Figure 15, as explained in the instructions on the reverse side, Figure 16. Under the second method, the first listing is made by having one salesperson call off the information and the second record it on the sheet. The data are then checked by having the one who recorded call off and the other check.

Stores not operating under the retail method must take the

	DEDUCTIONS	SELLING PRICE	GENERAL INSTRUCTIONS	SELLING PRICE	ADDITIONS
1			FIRST STOCK TAKER must list in columns 2, 3, 4, 5, 6, folding and sealing sheet as instructed. SECOND STOCK TAKER must then be notified that first listing has been completed.		
2					
3					
4					
5			SECOND STOCK TAKER must immediately begin listing in columns 7, 8, 9 on RIGHT side of sheet, notifying Comparer when finished.		
6					
7			COMPARER (Buyer or Assistant) must make immediate comparison of listings running down all differences at once. Correction must be made by crossing out, not rubbing out, old entry and interlining new one. Each correction must bear Comparer's signature.		
8					
9					
10					
11					
12			To facilitate comparison of listings, FIRST STOCK TAKER will mark on tag, label or box, etc., the number of the line on which the article is listed, SECOND STOCK TAKER will list the article on the corresponding line on his side of the sheet.		
13					
14					
15					
16			DEDUCTIONS AND ADDITIONS are to be made only on back of sheet by stating number of items taken out of or added to stock. Care must be exercised that this is on the same line as that on which article is listed.		
17					
18					
19					
20			Extreme care must be used in using the "Addition" and "Deduction" columns, to see that an addition is entered on the "Addition" side and a "deduction on the "Deduction" side.		
21					
22					
23			THIS IS IMPORTANT PRICE must always be entered when first deduction or addition is made.		
24					
25					

Fig. 16—Instructions for Taking Inventory.

cost price in addition to the information shown in Figure 13. In most cases this cost price is in code and must either be decoded as the inventory is taken or the code copied on the inventory sheet and later decoded. In either case there is more chance for error and more time is required than when only one set of figures is to be copied. As a rule, it is not advisable to allow all employees to know the code. Thus the

actual taking of physical inventory is usually done by fewer employees or by an inventory squad.

In some stores, it is the practice of salespeople to have the items counted at some time previous to the actual stock taking and, as sales are made, to make deductions from the original count. Although in departments, such as yardage goods, this practice need not be entirely eliminated, it has been found that a previous count results in more inaccuracies than an actual count at the time of taking the inventory. Failure to deduct sales and to record additions from reserve stock is common under any type of previous-count system. For this reason, stores should not permit, except in certain departments, any figures to be used for an actual count except those taken at the time of the inventory.

Inventory shortages.—The extension and totaling of stock sheets are done by the store's own clericals, by extra clericals, or by an independent concern. The results of the inventory are usually available for comparison with the book inventory within two or three days after stock has been taken. The totals should show the total amount of merchandise in the department and the totals by season letters. Any deviation between the physical inventory and the book inventory is called a stock shortage or overage, as the case may be. This discrepancy may be caused by an inaccurate physical count of merchandise on hand, an error in arriving at the book figure, or an actual loss of merchandise due to theft by customers or employees. In most departments an allowance is made for inventory shortage based upon past experience. If the actual shortages or overages are larger than the allowance a second count is usually taken immediately. Inasmuch as the accuracy of the net profit of each department and of the business as a whole is dependent upon the accuracy of the physical inventory, it is important that in so far as possible the error be proved either in the book inventory or in the physical count.

In arriving at the book inventory, provision is made by most stores to take account of all changes in stock from one period to another. The book inventory starts with an actual count. Therefore, the physical and book inventories are the same at the beginning of the season. Forms are provided for the

recording of all charges to the department or additions to stocks, such as purchases, returns and allowances to customers, inter-departmental transfers, additions to stock through the repair room, window display or advertising office, comparison office, mark-ups and mark-down cancellations. On the other hand, provision is made for the recording of all retail deductions, such as sales, breakages, mark-downs, mark-up cancellations, returns to manufacturers, charges to employees due to lost merchandise, or discounts to customers and employees. If all deductions and additions are accurately recorded, the only shortage which should exist is that which is due to unauthorized removal of merchandise by customers and employees.

In checking for inventory shortages, therefore, each of the clerical records should first be examined by following the flow of paper records through from the time a charge is made to the department until the merchandise has actually been credited through sales. The next step is to follow the physical flow of merchandise through the store from the time it is received until it is accounted for, either in stock or by money received through its sale. In an analysis made by a group of stores in Boston, ninety-seven possible causes for errors in the book inventory were recorded and nine causes for errors in taking the physical inventory. For each of these possible errors or reasons for shortages a remedy was suggested. Although the detailed causes of error fall into many subdivisions the major causes may be summarized as follows:

I. Clerical reasons for shortages:
   1. Failure to charge correct amount of merchandise to department.
      a. Charging of invoice to wrong department.
      b. Incorrect check of merchandise with invoice.
      c. Crediting wrong department with merchandise claims and returns to manufacturer.
   2. Wrong prices attached to merchandise due to the issue of wrong price tickets when first placed in stock, when reticketed after a mark-down is taken, or when returned by a customer.
   3. Failure to record price change as mark-up and mark-down.

4. Sales credited to wrong departments by salespeople or auditors.
5. Refunds, returns, and adjustments charged to wrong departments by section manager or auditing department.
6. Amount on sales slip not agreeing with merchandise actually sold, as to measure, weight, or count.
7. Errors in extension and additions by:
   a. Salespeople.
   b. Auditing department.
   c. Merchandise control section.
8. Error in charging merchandise out of department or crediting merchandise received from:
   a. Advertising office.
   b. Comparison office.
   c. Display department.
   d. Repair.
9. Failure to record breakage within store.

II. Physical reasons for shortage.
   1. Theft by customers or employees.
   2. Loss of merchandise in transit within the store.

III. Causes of error in physical inventory.
   1. Errors and omissions in physical inventory.
      a. Merchandise taken without price tickets.
      b. Original price taken rather than final price in marked-down merchandise.

Initial marking.—The first step in the prevention of inventory shortage is the accurate marking of merchandise, so that the total of retail prices attached to the goods is the same as the amounts charged on the invoices. This requires an accurate check of merchandise against invoice, and then a check of the retail price tickets against the retail price appearing on the invoice. Two general systems are used by stores to get an accurate check of merchandise against the invoice. The first is a "blind check," in which the checker lists on a sheet the merchandise which he finds in each container, without seeing the amount listed on the invoice. This sheet is then compared with the original invoice. If the merchandise on the sheet does not correspond with the invoice a second check is made usually by another person. The second method is

to check the merchandise directly against the invoice. The first method, although requiring more time and operation, eliminates the possibility of error due to the psychological tendency of checkers to find the number of items which they know should be present as shown by the invoice. Either method, however, is sufficiently accurate if properly supervised and checked.

In order to insure that the same retail price is attached to the merchandise as appears on the invoice, a sample of each item may be retailed by the buyer from which the others are marked or the price tickets may be made directly from the invoice and attached to the merchandise. The advantage of the first method is that the store makes certain that the right prices appear on the merchandise. Such a system, however, gives an opportunity for the buyer to retail the sample at a different price than the invoice shows, thus covering up an inventory shortage. Under ordinary circumstances this could not be considered a serious disadvantage to the proper control of inventory. By retailing the sample, the buyer is given an opportunity to see each line of merchandise and to appraise its value in relation to the price he places on it, whereas, if the price tickets are marked directly from the invoice, some lines of merchandise may reach the selling floor bearing retail prices which are out of line with their intrinsic value. Regardless of the system used it should be checked periodically.

Reserve stock control.—Merchandise charged to the department is divided into reserve stock and forward stock. In some stores a merchandise control is kept separately for each division; that is, a record is kept of merchandise charged and credited to the reserve stock. In this way a merchandise shortage can be allocated either to the selling floor or the reserve stock room. In keeping these book inventories separate, the only additional current data which are necessary is a record of the merchandise charged in the reserve stock room and a credit for all merchandise sent to the selling floor or returned to the manufacturer. The physical layout of the store is the most important factor in determining which method should be used. If there is proper ingress and egress control of the receiving and reserve stock room, and a direct flow of merchandise from reserve to forward stock, the use

of subsidiary control is usually not practical. However, if reserve stock rooms are in different buildings or storehouses, a separate book inventory should be maintained. Another factor is distance from the central market, or the time element of delivery. The amount of merchandise carried in reserve stock varies directly with the length of time required for delivery. Still another consideration in the control of reserve stock is the nature of the merchandise, the amount required for a complete stock, and the importance of the style element. Millinery requires a very small reserve stock, because it is highly seasonal, and is sold directly rather than from sample. On the other hand, furniture, as a rule, is sold by sample, and therefore requires a large reserve stock. Good merchandising requires that the flow of goods from the receiving room to the selling floor be as direct as possible. With the emphasis upon rapid rate of stock turn, the tendency in most departments is for merchandise to go directly to the selling floor rather than through the reserve stock room.

Control of price changes.—In retail stores the selling price must be fixed definitely upon the arrival of the merchandise, and both the invoice and the goods must be marked at the same retail price. This determines the mark-up per cent, which is assumed to be the fair and proper relation between cost value and retail value of the goods in the different departments.

It makes little difference what system is used for mark-up and mark-down, so long as it provides for proper authority and centralized control. In most well regulated stores the authority to make a change in the original retail price must come from the merchandise manager. Figure 17 shows a convenient form for the proper control of mark-downs. It provides the necessary information as to the reason and amount of mark-down, the new price, the season letter, the classification number, and a serial number for the purpose of auditing.

The centralized control properly should be under the receiving department, and no other department should be allowed to make price changes, except under the supervision of a representative of this department. The reason for this is evident, inasmuch as subsequent price changes are just as important for purposes of control as the original marking. After a

price change is approved, the mark-up or mark-down book is turned over to the receiving department which makes the authorized price changes. At the present time, there is no standardized practice in the actual procedure in making price changes. Goods may either be re-marked in the department or in a centralized marking room. The nature of the goods and the physical layout of the department and store are the

No. X 1251 **MARK DOWN RECORD** DEPT. ________

DATE ________ 192__

SEASON LETTER	CLASS NUMBER	LOT NUMBER	ARTICLE	QUANTITY	OLD PRICE PER UNIT	NEW PRICE PER UNIT	DIFFERENCE	TOTAL REDUCTION	REASON FOR REDUCTION

NOTE: If the reduction is for a special sale, write the word "Sale" after the item in the column "Reason for Reduction." If not for a special sale, specify the following reasons as they apply:

1. Style Depreciation
2. Discontinued Line
3. Broken Assortment
4. Unseasonable
5. Adjustment
6. Breakage
7. Soilage
8. Theft
9. Competition
10. Allowance
11. Samples
12. Price too High
13. Bought too Many

TOTAL ________

SIGNED ________ BUYER

SIGNED ________ MDSE. MGR.

Fig. 17—Mark-down Record.

controlling factors. So long as the goods to be marked are clearly designated they may be as accurately re-marked within the department as at a central point, and the actual change of price may be made by the salespeople if they are under the supervision of the receiving department.

When the mark-down is completed the record of price change should be sent immediately to the controller's office, that the proper adjustments can be made in the department stock. The sheets of the mark-up and mark-down book should

be numbered and a control form should be maintained in the controller's office for all price change sheets, so that they may be audited and delayed or missing sheets procured and passed through. Records of price changes should be made in duplicate, one remaining in the mark-up and mark-down book, to insure the proper audit of missing sheets. In case the mark-down is for a short period, after which the price is to revert to the original figure, some stores allow the salespeople to keep a record of the merchandise sold at the reduced price and a mark-down is then taken for the total amount. This is especially common in the yardage goods department, where it is difficult to measure all the merchandise before and after the price changes. This method results, in most cases, in serious errors and inaccuracies, due to the failure of salespeople to record the amount of sales. To overcome these errors some stores have both the original and reduced price copied on the sales slip, which is audited to get the mark-down. This system is to be recommended in preference to the former. In case of a flat percentage mark-down, the total may be arrived at accurately by an audit of the sales check, the same as a discount to employees or customers. The common practice in stores which maintain an accurate inventory control, however, is to count all merchandise before and after a sale, taking mark-down on all merchandise offered for sale and a mark-down cancellation on merchandise remaining. The difference between the total mark-down and the mark-down cancellation is the net mark-down.

After merchandise has been charged to a department, the movement of every item should be represented by a paper record. The first essential in correlating the physical and book inventory is a thorough understanding on the part of every employee that each paper record of change is just as important as the merchandise itself. In other words, the paper represents the merchandise, and its loss or failure to get on the original records will cause a shortage or overage. The cause and remedy for inventory shortage or overage can be found only by detailed research and analysis in the individual departments in which the shortage occurs. In some of the larger stores a special staff is placed in charge of this research. The advantages of having a special research staff in charge of inventory are: (1) the causes of shortage being

common among the different departments, the research in one department aids in detecting errors in other departments; (2) as the check for inventory shortages is done by some one outside the department, an unbiased conclusion may be drawn.

Importance of accurate book inventory.—It is important that an accurate book inventory be maintained: (1) because it is on the basis of a book inventory that profits are figured from month to month and that merchandise plans are made; (2) it is only through an accurate book inventory that a real shortage can be detected. If a department manager is to use the book figures he should have a reasonable amount of confidence that they are approximately correct. To a large degree stock shortages are internal in character. That is, they represent not an actual shortage of goods, but faulty operation of the perpetual inventory system. The failure to record a $100 mark-down has the same effect in causing an inventory shortage as the theft by a customer of $100 worth of merchandise. The one is an actual shortage or loss, the other, only a paper shortage; (3) an accurate book inventory tends to strengthen the morale of an organization. The psychological effect of accurate merchandise control tends to prevent laxity in the handling of both merchandise and the paper records representing the merchandise. An organization which gives the impression to its personnel that there is a close check-up between physical count and book or statistical inventory decreases the tendency toward inaccurate accounting. In many stores the purpose of accurate accounting is for discipline as well as for statistical records.

Inventory shortages are usually expressed as a percentage of sales. For instance, if the sales for a particular department are $10,000, the book inventory $5,000, and the physical inventory $4,500, the stock shortage would be $500 or 5 per cent of sales, although 10 per cent of the stock which should be present, as shown by the book inventory, is missing. Therefore, in a department showing a stock shortage of 5 per cent of sales and a stock turn of 10 (figured on book inventory), the physical inventory is only 50 per cent of the book inventory. It is felt by most stores that a stock shortage percentage figured in sales gives a more comparable and representative figure, because it shows the percentage of merchandise short in proportion to total merchandise handled

during the period, rather than the amount of merchandise in relation to the book inventory at any particular time. By multiplying the percentage of inventory shortage to sales by the turnover figure, the percentage of shortage to book inventory can be obtained.

In January, 1924, a store with 53 departments had an overage in 16 departments and a shortage in 37 departments. The overage varied from 3 per cent in dresses to 21.7 per cent in stationery and fountain pens, and the shortage varied from .2 per cent in draperies to 34.4 per cent in dolls. These percentages were figured on book inventory rather than on sales, and for this reason are not comparable between departments. For example, the high percentage in dolls was largely due to the low book inventory on January 31 rather than to a large shortage in dollars.

Allowance for inventory shortage.—Inventory shortages vary widely in different stores and in different departments within stores. The amount of shortage depends to a large degree upon the layout of the department, the methods of statistical control, and the general policy of the management. For instance, in one store in Boston, the shortage in the millinery department runs from .5 of 1 per cent to 1.5 per cent, whereas in the same city another store has an inventory shortage running as high as 5 per cent. In the former store all the millinery is in show cases and, in the latter, it is displayed on long, open shelves. The following figures, Table 19, show the percentage of stock shortage to sales by Federal Reserve districts for the years 1912 to 1921, as compiled by the Controllers' Congress of the National Retail Dry Goods Association:

TABLE 19

PERCENTAGE OF STOCK SHORTAGES TO SALES

Year	*No. 1*	*No. 2*	*No. 3*	*No. 4*	*No. 5*	*No. 6*	*No. 7*	*No. 8*	*No. 9*
1912......	0.88	1.55	2.3	0.41	—	—	—	—	1.28
1913......	0.89	1.71	3.2	0.42	1.72	1.03	—	0.89	2.15
1914......	0.88	1.49	1.6	0.53	1.20	0.96	1.86	1.42	2.80
1915......	0.56	1.34	1.6	0.40	0.89	1.07	1.98	0.74	2.10
1916......	0.46	1.26	1.2	0.49	0.78	0.92	0.90	0.77	2.04
1917......	0.61	1.15	1.1	0.51	0.72	0.94	0.58	1.41	2.01
1918......	0.37	0.98	1.6	0.87	0.49	0.79	0.59	1.01	2.17
1919......	1.15	1.37	1.3	1.19	0.93	0.69	1.07	0.93	2.20
1920......	1.54	0.74	1.9	0.92	0.92	0.98	1.70	1.77	2.70
1921......	1.49	1.04	1.3	0.77	0.79	1.60	1.72	1.15	3.20

These figures vary from ⅓ per cent to 3.2 per cent, with a common figure of about 1 per cent of sales. In a store in New York doing an annual business of approximately $50,000,000, the total inventory shortage averages less than 1 per cent of sales, or about half a million dollars at retail. The shortage allowance for individual departments in four different stores is shown in Table 20 below. These percentages were determined from the past experiences of the individual stores:

TABLE 20 *

SHORTAGE ALLOWANCES

(Per cent of, to Sales)

Department	*Store No. 1 Per cent*	*Store No. 2 Per cent*	*Store No. 3 Per cent*	*Store No. 4 Per cent*
Women's suits	½	½	½	½
Women's coats	¼	¼	½	½
Women's dresses	1	¾	1	½
Misses' suits	½	1½	¾	½
Misses' coats	½	¼	¾	½
Misses' dresses	½	1½	¾	½
Furs	2	3	2	3½
Millinery	5	2	½	7
Waists	1	4	3	1½
Sweaters	1	¾	2	2
Women's hosiery	½	1½	4	3
Women's handkerchiefs	½	1	1	4
Women's gloves	3	2	4	3
Infants' wear	½	½	2	1½
Toilet goods	4	2½	2	2½
Knit underwear	½	1	2½	1½
Silks	2	...	...	3
Dress goods	2	...	...	3
Glassware	2	...	...	2
Men's furnishings	½	...	...	½

* Controllers' Congress, National Retail Dry Goods Association: "Report of Fifth Annual Convention."

Method of handling inventory shortage.—It is generally recognized that in order properly to control the merchandising activities of a store or a department, the management should have some way of determining periodically the profit that it is making without resorting to an actual physical inventory. The retail method of inventory provides a method of reducing the book inventory to cost, and of determining from this figure gross margin at any particular period desired. The accuracy of the gross margin determined in this way, however, de-

pends directly upon the accuracy of the book inventory figure. For instance, if the book inventory, in a department with an average mark-up of 33⅓ per cent, is $15,000 at retail at the end of a year, and the physical inventory is $12,000, there is a shortage of $3,000. A gross margin derived from the book inventory would be $2,000 (66⅔ per cent of $3,000) higher than the real gross margin as determined from the physical inventory. Since the shortage of $3,000 developed over the period of a year, there was, presumably, at the end of the first month a shortage of 1/12 of $3,000, or $250; at the close of the second month a shortage of 2/12 of the $3,000, or $500; and so on to the end of the year. In other words, if the gross margin were figured from the book inventory at the end of the first month, it would be overstated by 1/12 of $2,000, at the end of the second month 2/12 of $2,000, and so on to the end of the year, when it is overstated by the full $2,000. If corrections are made in gross margin, therefore, only at the end of a season or a year, there is a cumulative error or overstatement of profit throughout the season. In some cases this fictitious profit leads to serious mistakes in planning, especially during the latter part of the season, and a general misunderstanding on the part of buyers who, as a rule, cannot understand how the profit which they have been showing monthly during the period has been decreased by a physical inventory.

In order to overcome this overstatement of profit, many stores have adopted the practice of making a monthly allowance for inventory shortage. On the basis of the actual results over a period of years, the percentage of inventory shortage to sales is determined, which is used as an estimate of the inventory shrinkage for the next season. In determining the profit for any month or period of the season, this percentage is added to the cost of sales. The result, of course, is to lower the per cent of maintained mark-up, so that the buyer gets an approximation of his real profit for each period rather than a paper profit. At the end of the season, inventory is taken in all departments and the actual shortage ascertained. If the actual shortage is more or less than the estimated shortage, the corrections are made so that the books will show the actual shortage. This method is advantageous, in that it

anticipates periodically the decrease in profits due to inventory shortages. Another advantage is that if a buyer knows that each month his maintained mark-up will be decreased by a certain percentage he can fortify himself by extra effort during the entire period. Table 20 shows the allowances in percentages which are made by some stores in individual departments where the system is used.

A third method of handling shortages is to take periodic physical inventory, in order to determine profit rather than to wait until the end of the season or year. The number of physical inventories taken depends upon the amount of shortage in the different departments as determined by past experience. Under this method no allowance is set up for shortage, but entries are made for the actual overage or shortage after each physical inventory. An inventory schedule that is used by a number of stores is shown in Table 21 below:

TABLE 21

INVENTORY SCHEDULE

If annual per cent of shortage is	*Inventory shall be taken*
0.50	Once in 6 months
0.50 to 0.75	Once in 4 months
0.75 to 1.00	Once in 3 months
1.00 to 1.50	Once in 2 months
Over 1.50	Every month.

This method has practically all the advantages of the second method, except that it necessitates a greater number of physical inventories. A department is moved from one group to another only when two successive inventories have fallen within the same group. Thus, if in a department with a shortage of from 1 per cent to 1.50 per cent annually the shortage decreases to below .5 per cent for two successive inventories, the physical inventory may be taken once in 6 months instead of once in 2 months. Another advantage in the use of a periodic physical inventory in departments showing large shortage is that a better opportunity is given to locate and correct the cause of the shortage. In some departments in which the shortage is large a daily check is made until the cause of the shortage is located.

Slow-selling Merchandise.

The following figures show the percentage of stock to total at the different ages, in twelve department stores with sales volume from five to ten million dollars in 1923.

Store Number	*Per Cent Over 6 Months Old*	*Per Cent Over 1 Year Old*	*Per Cent Over 2 Years Old*
1	24.2	15.7	3.6
2	17.59	11.57	3.37
3	29.00	15.00	8.00
4	20.00	4.00	1.00
5	24.00	8.00	2.00
6	40.00	17.00	....
7	....	5.96	....
8	28.59	8.72	13.79
9	21.00	11.00	....
10	35.00	11.00	3.00
11	28.00	9.00	
12	35.00	12.00	

The length of time that goods should remain in stock before being sold depends chiefly upon the rate of stock turn of the store or department. If the rate of stock turn is four, it is presumed that goods remaining in stock for more than three months ($12 \div 4$) are slow selling. Any considerable amount of such merchandise will affect the rate of stock turn, inasmuch as it increases the average amount of stock carried. This does not mean, however, that a store cannot maintain a high rate of stock turn in a department in which there are slow-selling items. For, by concentrating on the fast-moving lines, it is possible to minimize the negative effect of slow-selling stock. An item selling in two months, in the example given above, would completely counterbalance the negative effect of an item of the same price selling in four months. It may readily be seen that a stock turn of four in a department may actually mean a stock turn of two on one-half the goods and of six on the other half, or even a wider divergence in selling time. In some stores, systems have been installed whereby slow-selling merchandise is detected by items.

A system for the recording and control of slow-selling merchandise may be operated by the buyer, or from the merchandise, or the controller's office. In most cases actual ex-

perience has shown that the check-up must be taken out of the hands of the buyer because: (1) the recording of data and the checking of records are not naturally included in his functions; and (2) the check of slow-moving merchandise, if done by the buyer, would have a tendency to be biased, because of his personal interest in showing a good record and his optimism that merchandise is not really slow-moving. Theoretically, the checking of slow-moving merchandise should be under the finance and control division, inasmuch as an investment in stock which does not sell within a certain period becomes a frozen asset. In one of the larger stores in New York City the control of merchandise is under the merchandise division until it has been in stock a certain length of time, after which it passes under the control of the finance division. Some stores feel, however, that, inasmuch as the determination of when merchandise is slow-selling and of its final disposition are functions of the merchandise office, this office should have complete supervision of all merchandise control. Regardless of the major supervision of slow-selling merchandise, the larger stores have found it advisable to create a separate department to take charge of the slow-selling stock for the store as a whole.

Method of decreasing slow-moving merchandise.—The causes of slow-selling merchandise should be classified as controllable and uncontrollable. Adverse conditions, such as a change of weather, business depression, and a change of style or custom, are uncontrollable so far as retail stores or buyers are concerned, and should be clearly differentiated from an overstock of merchandise due to poor salesmanship, display or advertising, buying too far in advance of requirements, carrying too many styles or prices, or permitting an accumulation of end sizes. The sales of raincoats and rubber overshoes are directly dependent upon wet weather, and an exceptionally dry season will necessarily result in low sales for these lines of merchandise. Similarly, a decrease in the purchasing power of a community caused by unemployment, labor trouble, or business depression will necessarily result in decreased sales in certain lines of merchandise. Because of the lack of regularity with which these changes occur, it is difficult to anticipate them far enough in advance to make adjustments in stock.

The first step in the prevention of slow-moving merchandise is to buy, so far as is possible, what is selling, and in the proportion in which it is selling as to color, size, material, and style. The stores that have been most successful in eliminating slow-selling merchandise are those that have introduced a perpetual piece control with a current record of the items that are selling and the amount remaining in stock. Purchases and stock are thus regulated and adjusted to the sales record. In these stores a buying and selling calendar is developed by a study of past records of each season, showing the length of time required to secure different lines of merchandise from various manufacturers, the number of items in each classification needed to meet the expected sales, and the times when the orders should be placed to insure delivery when needed. Such a plan enables the buyer to time his purchases in accordance with his planned stock requirements for each week or month, and thus to maintain the proper relationship between sales and stocks.

The next step is to adjust purchases and stocks in accordance with the expressed wants of the customer as recorded by the want slips and suggestions made to the salespeople. This is especially necessary at the beginning of the season. Early buying in style merchandise must be done cautiously. As the weeks go along, good lines and good models will stand out. This is the time to place larger orders, for customers have indicated what they want. In other words, a buyer must build carefully up to the beginning of mass buying. A current record should be kept of what is selling elsewhere as shown by the shopping of the comparison department, the reading and observation of the buyer, and information from vendors' representatives.

Conflicting price lines and styles increase the number of slow-selling items. Well-zoned prices are now necessary in most departments if slow-moving lines are to be eliminated. A study of these zones will show where it is best to invest. If $3 and $2.95 hosiery are carried in the same department, the sales in one price will necessarily cause a decrease in the sales of the other. Similarly, if a store carries several brands of black silk hosiery at $3, the rate of turnover of this price zone will be less than if only one brand is carried. The increased sales due to a wider number of brands are not in pro-

portion, as a rule, to the average stock which must be carried for each brand.

In some lines of merchandise, such as shoes, shirts, and collars, the accumulation of end sizes often results in slow-moving stock and resultant slow rate of stock turn. When a range of sizes is badly broken, it is difficult to sell left-overs even at greatly reduced prices. In one case which was reported to the Harvard Bureau of Business Research, the proprietor of a shoe store attempted to rid his stock of "out sizes" and styles of women's shoes no longer in demand, by means of a $1 sale lasting three days which he advertised extensively in the newspapers. Although the original retail prices of these shoes ranged between $4 and $12 per pair, there were only 193 pairs sold out of 379 advertised. This is a typical instance of the difficulty met with in attempting to dispose of end sizes. In order to prevent the accumulation of odd sizes, most stores provide for frequent size-ups and make purchases in accordance with the sales record.

After careful buying, the next step in decreasing slow-selling stock is judicious pricing, marking the goods at lowest prices consistent with safety and reasonable profits. If customers do not purchase merchandise after it has been brought to their attention and the value-giving qualities explained, it is because the price is higher than the evident satisfaction which the merchandise will give. Failure to display and advertise the goods so as to bring out the value-giving qualities will, of course, increase the amount of slow-selling stock. Value, from a merchandise point of view, exists only in the mind of the customer and consists of the sum total of satisfactions which she expects to get out of the article. Whether or not a certain price will move the merchandise depends on how effectively the reason for the price is brought to the attention of the customer through display, advertising, and salesmanship.

Finally, in order to decrease slow-moving merchandise, it is necessary for a store to have a system whereby slow-moving lines may be currently detected. The method of detecting lines which are not selling in some stores is to make a periodic inspection, examining all the items as to the length of time in stock. If consistently followed, this perhaps would be the most effective method of increasing the rate of stock turn.

However, most stores have found that, in order to control slow-moving lines, it is necessary to adopt some system whereby they are automatically detected.

Systems used.—The importance of a check-up system and the method used vary with the different departments according to the nature of the merchandise. In most stores, physical inventory is taken at least twice a year and merchandise is listed according to season letters or the time at which it was placed in stock. Thus, a department's stock may be classified by age as less than 3 months; 3 to 6 months; 6 to 9 months;

S. M. M. RECORD SHEET DATE. 192

NOTE: PLEASE USE INK

UNDER QUANTITY STATE WHETHER PIECES DOZEN GROSS OR YARDS DEPT

SECTION & SHELF	ARTICLE	SEASON LETTER	QUANTITY ON HAND	PRICE	MARK UP OR MARK DOWN	AMOUNT SOLD FEB AUG	MAR SEPT	APRIL OCT	MAY NOV	JUNE DEC	JULY JAN	REMARKS
	TOTALS											

Fig. 18—Slow-moving Merchandise Record Sheet.

and 9 months or older. This type of check is more of a post mortem, inasmuch as it merely indicates the length of time that goods have been in stock. In a department with a high rate of stock turn, the physical inventory must be supplemented by a check at least once a month. From the physical inventory sheets a record may be taken on a slow-moving merchandise record sheet as shown in Figure 18. This record shows the exact location of the slow-selling merchandise so that it may be easily checked. Once a month a record is taken of each article showing the price changes and the amount sold.

Figure 19 shows a slight variation in the method of recording the movement of slow-selling merchandise. Before the 10th of each month in this store, the quantity and price

of each article listed on the slow-selling sheet is recorded. The difference between the quantity remaining each month shows the rate at which the merchandise is being decreased through sales and reductions. The price changes from month to month give a historical study of mark-downs and their effect upon sales. Some buyers feel that it is better to take a series of small mark-downs rather than a large initial mark-down. A study of the price changes as shown in Figure 19 should give sufficient data from which a conclusion may be drawn as to the best policy of taking mark-downs in the different departments. Each month a summary is taken on the

NO.

DEPARTMENT__________INVENTORY DATE__________

SLOW SELLING STOCK

THESE SHEETS MUST BE TURNED IN TO THE STATISTICAL OFFICE
ON THE 10TH OF EACH MONTH WITH ALL DATA SHOWN COMPLETE

STYLE NUMBER	ARTICLE	SEASON LETTER	QUANTITY							PRICE						
			INV.	FIRST MONTH	SECOND MONTH	THIRD MONTH	FOURTH MONTH	FIFTH MONTH	SIXTH MONTH	INV	FIRST MONTH	SECOND MONTH	THIRD MONTH	FOURTH MONTH	FIFTH MONTH	SIXTH MONTH
			DATE	DATE	DATE	DATE	DATE	DATE	DATE	DATE	DATE	DATE	DATE	DATE	DATE	DATE

Fig. 19—Slow-selling Stock.

form, Figure 20, of the movement of slow-selling stock, showing the amount on hand of each season letter, decrease for the season, reduction for the season, the decrease and reduction for the month, and the percentage decrease for each column.

A more current check for slow-moving merchandise is made in some stores by taking monthly or weekly physical inventory in departments with a high rate of turnover. This is supplemented by weekly or daily checks on the slow-moving lines. Although this is not practical in all departments, it is especially to be recommended in highly seasonal merchandise, such as ladies' ready-to-wear and millinery. One of the largest stores in New York establishes a rate of sales in some departments for each particular line. For example, in shoes, a certain

number of pairs must be sold each week—the number varying in relation to the size of the weekly purchase and stock on hand. In this store the tendency is to buy first and then to set a sales quota rather than to buy according to a predetermined sales quota and planned stock figure.

SLOW SELLING REPORT

DEPT.________________

________________________ ________________192___

SEASON	INVENTORY ______192__ (AT RETAIL)	ON HAND ON ABOVE DATE (AT RETAIL)	DECREASE SEASON	REDUCTION SEASON	DECREASE MONTH	REDUCTION MONTH
Previous						
O Fall 1919						
R Spring 1920						
S Fall 1920						
T Spring 1921						
V Fall 1921						
W Spring 1922						
X Fall 1922						
A Spring 1923						
B Fall 1923						
E Spring 1924						
G Fall 1924						
H Spring 1925						
TOTAL						

Percent Decrease.

REMARK.

Fig. 20—Slow-selling Report.

Inspection by merchandise manager and buyer.—In some stores it has been found that a statistical record of the movement of slow-selling merchandise must be supplemented by a systematic inspection of the items by the buyer or merchandise manager, so that the reasons why the merchandise is not moving may be studied on the selling floor. At regular intervals, depending upon the type of merchandise, all items bearing an old season letter are placed on the counter or physically separated from the other merchandise, that they may be studied by

the head of the department and the merchandise manager. In some stores a group of the executives of the store make a periodic inspection of the merchandise as it is separated from the other stock. The object of this inspection is to determine the best method of disposing of each article. In some cases a change in the display or layout of the stock is recommended. In one store a suite of furniture was listed on the slow-selling sheet. An interchange of position of two or three suites resulted in a movement of that suite without a mark-down and without advertising. The inspection may result in drastic mark-downs in some cases and advertising and window-display in others. It is felt that an inspection of this kind, if properly conducted, results: (1) in attracting the attention of salespeople to the slow-moving items, thus emphasizing the importance of bringing them to the attention of the customer; (2) in bringing the items to the attention of the buyer in the presence of other executives who are responsible for the investment of the store's capital, thus emphasizing to the buyer the importance of careful buying and judicious pricing; and (3) in the development of a more logical method of disposing of the merchandise.

Advantage of slow-selling system.—A properly operated system for the control of slow-moving merchandise keeps stock clean and fresh by preventing an accumulation of old merchandise. It increases the rate of stock turn by indicating the goods that should be marked down and turned quickly. A slow-selling system avoids excessive mark-downs by giving information in time to consider means for their disposal during the seasonable selling period instead of at-end-of-season sales, resulting in greater losses. It further establishes a ratio between total stock and goods not moving, thus helping to keep stocks properly balanced. A properly operated system prevents the reordering of unsalable goods and compels discrimination in buying.

It should be emphasized, however, that no paper record or follow-up can take the place of a buyer's current inspection of merchandise. The slow-selling system, in most cases, is used merely to set a limit beyond which merchandise should not remain in stock. As a general rule, the installation of such a system results in stimulating the buyer to a more frequent inspection of stock.

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Problems.

1. The following figures (at retail) represent the operation of the millinery department in a store in Boston for a six-months' period:

Gross sales	$92,000
Stock on hand at beginning of period	24,000
Net purchases	83,000
Mark-downs	7,000
Returns by customers	8,000
Physical inventory of merchandise at the close of the period	14,000

(*a*) What was the percentage of inventory shortage?

(*b*) The actual net profit in this department for the period was $4,000, and the gross margin was 30 per cent. What would have been the net profit if the book inventory had been used?

(*c*) In another department of this store the inventory shortage for the year was 3 per cent of sales. This department showed a stock turn of six and the book inventory at the close of the period was $4,000 at retail. Assuming that the closing inventory figure represented the average stock for the period, what was the physical or actual closing inventory?

2. In 1923 the Alfred Benson department store had an inventory shortage of 2.8 per cent of sales. This store is located on the Pacific coast and has an annual sales volume of $9,000,000. Mr. Hadley, the controller, has made a very careful study of the store's systems and has recommended various changes and the adoption of several new systems. At the present time, all merchandise is received through a central receiving and marking room where it is checked against the invoices. If the

invoice has not arrived a list of merchandise received is made and either sent through as a "dummy invoice" or checked against the original invoice when it is received. After the retail price has been placed on the invoice by the buyer, tickets are made out on a marking machine and attached to the merchandise by markers. The controller has recommended that those who check the merchandise should not be given invoices, but should list the number of items which are found in each container, after which this listing would be checked against the invoice. He further recommended that the buyer place the retail price on a sample of each line of merchandise, to insure that the right-priced tickets are attached. At the present time the markers are given a box of price tags which they attach to the merchandise. Mr. Hadley recommended that the markers be given only the number of price tickets called for by the number of items on the invoice.

(*a*) Should Mr. Hadley's suggestions be adopted?

(*b*) Should any other changes in the present system be recommended?

3. The Martel department store has a sales volume of approximately $10,000,000, of which 1.6 per cent, or $160,000, is in women's gloves. The inventory shortage in this department in 1923 was 4.5 per cent of net sales as compared with an average shortage for the past four years of 4 per cent. The controller had adopted a system in this department which provides for a comparison between invoice and marked goods at least once a week. In order to facilitate this check, the system provides that the price tag which is attached to the gloves must bear the number of the invoice. This check is made before the goods go down to the selling floor. Closed containers are always used in moving goods from the marking room to the reserve stock room. During 1923 a close check was made to insure that gloves returned by customers were properly reticketed and returned to stock. This store has a large number of bargain tables in which special purchases and gloves marked down from regular stock are sold. Mark-downs are taken under the supervision of the receiving department after the mark-down requisition has been signed by the merchandise manager. The buyer is not allowed to change any prices. When mark-downs are taken the original price tags must be removed and new ones attached. With this system the controller feels reasonably certain that the shortage is real rather than a book shortage. Mr. Buell, the buyer, has suggested that a system should be installed which would permit the allocation of the shortage to regular stock and to stock sold on tables. He feels that such a system should indicate whether the shortage is due to theft or to clerical errors. He cited an instance in which 8,000 pairs of gloves were placed on sale on four bargain tables and all sold in two days. Although these gloves were sold for $1.75 a pair, an audit

of the two days' sales indicated that more than 400 pairs were unaccounted for. Mr. Buell feels that customers will buy more gloves if they are allowed to handle them. At the same time the large inventory shortage in 1923 caused the glove department to show a net profit of less than one per cent.

(*a*) Should Mr. Buell's suggestion be adopted?

(*b*) If so, what system should be used?

4. The dress-goods department of the Martel department store has a yearly sales volume of $380,000 or 3.8 per cent of the total volume of the store. The inventory shortage in this department in 1923 was 3.5 per cent. The controller feels that a large part of this shortage was due to faulty measurements. Samples are freely given and only yard sticks are used. Some of these are loose and some are attached to the counter. The merchandise is not measured when it is received by the store. In case of special sales or temporary mark-downs for other reasons the salespeople are required to keep a record of the number of yards sold at the reduced price, and the amount of the reduction is based on the report of the salespeople. The buyer feels that it is too much trouble to measure the goods before and after the sale. It is only when the goods are permanently marked down that they are actually measured.

(*a*) What change of system should be recommended for this department?

5. In a recent talk before a group of buyers the manager of a specialty store stated that an investigation in a department showed that there were 77 price lines, but that 73 per cent of the business had been done on eight of them. Similar investigations in other stores have disclosed the fact that, regardless of the number of prices carried, a very large percentage of the total sales are made from only a small percentage of the price lines.

(*a*) What is the general cause of a wide range of prices in a line of merchandise?

(*b*) What are the specific advantages and disadvantages in carrying a wide range of prices?

(*c*) The store having 77 price lines, in the department mentioned above, installed a stock-record system. By the use of this system it was able in December, 1923, to increase its sales in this department 95 per cent over the corresponding month of the previous year. During December of 1923 it carried only 29 price lines in this department and did 72 per cent of its business on three price lines. The stock during the latter month was 16 per cent less than in 1922.

How may a store decide what lines to buy, what to continue, and what to discontinue?

6. As assistant to the merchandise manager, you are assigned to a department to make a report on the causes of a slow rate of turnover.

- (*a*) Outline your method of attack, indicating how you would determine:
  - (1) Whether or not the turnover is actually slow.
  - (2) What lines are moving and what are not moving.
- (*b*) Outline a system for the control of slow-moving lines in a department with a stock turn of four.
- (*c*) Name four of the major advantages resulting from a properly operated system for the control of slow-selling merchandise.

7. The Mendel department store is located in a large eastern city and has an annual sales volume of approximately $18,000,000. It succeeded in turning its stock seven times in 1923.

The Mendel store operates on a cash basis and emphasizes a rapid rate of stock turn with a low mark-up. The merchandise manager recently asked each of the seven divisional managers to submit a plan for the control of slow-moving merchandise. Among the plans submitted was one by Mr. True who has charge of the basement store. Mr. True suggested that the departments first be classified under two major headings—those whose stock turned rapidly and those with slower turnover. In the former group of departments the merchandise should have a different-colored price tag each week and in the latter group the color of the price tag should be changed each month. Thus, all merchandise purchased during January in departments with slow-moving stock would bear a pink tag, that purchased in February a blue tag, and so forth. By going through the department a buyer could readily recognize the age of the stock and make plans to dispose of it.

Should Mr. True's plan be adopted by the Mendel store?

Chapter VIII

THE MERCHANDISE BUDGET

Retail merchandising is the function of buying and selling merchandise, and of bringing about the most advantageous proportion between sales, stocks, and net profits. It includes the planning for and control of purchases and the estimates of future sales. As in other businesses, it is the manipulating of a stock investment for the greatest amount of ultimate net profit. Good merchandising requires that the money invested in stock brings a return, by contributing to the total net profit of a store either directly or indirectly. Because of competition, some money obviously is invested in lines of merchandise which are sold at a net loss. If all expenses were equitably distributed to each item of merchandise sold, there would be a large percentage of merchandise which would show no net profit. The nearer the buyer can judge the needs and demands of his trade as to quality, quantity, and price, the quicker he can dispose of his stocks, and get his capital back through sales. This, if it is done profitably, is practically the whole science of merchandising.

The principle of a scientific merchandise plan is to regulate the purchases or additions to inventory in such a way as to maintain complete and well-assorted stocks in relation to sales. Complete stocks need not necessarily be large; but, if properly controlled, there will be an assortment of merchandise in quantities and prices which are in direct proportion to demand. The first step in a merchandise plan is the control of purchases covering the entire store, or departments within the store, based upon planned sales and stock. The second step is the control of purchases for subdivisions of departments, or classifications of merchandise, based upon the planned sales and stocks of each subdivision; and the third and final step is the control of purchases of individual items of merchandise through the use of piece records, which show, at all times, the

quantity of stock on hand and the sales in lines of merchandise according to style, price, size or color. This is called a perpetual piece control, and should be clearly differentiated from perpetual inventory in dollars, which is found by adding the amount of purchases to the amount of goods on hand at the beginning of the period and subtracting the goods sold. This amount in dollars, however, does not indicate the relative number of different items of which the total stock is made up. A few items may be extremely heavy, and others light. It is only by reference to the subdivision or piece records of the department that the actual condition of the department may be known.

The six-months plan.—The basis of an effective merchandise plan is a current record of merchandise on hand and the amount being sold, so that purchases may be made accordingly. In order to control the amount of money invested in stock a large number of retail stores make out a plan or budget, setting down on paper, in advance of the opening of a season, definite objectives which the merchandise division may use as a guide during the period covered. It is generally recognized that, for the purpose of planning the major merchandising operations, the fiscal year should be divided into two parts, of six months each, and a merchandise plan should be drawn up covering each half-year period. This may be called a "merchandise budget," a "merchandise plan," or a "six-months plan." It is essential that such plan be simple, that is, easy to understand and to operate. It is made for two major purposes: (1) to help the buyer regulate his purchases for the different periods; and (2) to give the controller an idea of the amount of revenue which may be expected from each department of the store, and also the amount of working capital which each department will need during the period.

The aim of every type of business is to operate on a capital that is small in proportion to sales, and thus get a high rate of capital turnover. The capital necessary to operate a department varies with the different periods of the year. For instance, in the ready-to-wear department, the suit and coat stocks should be at their lowest point of the season about June 1, whereas the blouse, dress, and skirt departments should be at their peak at this period. If properly scheduled, the capital which is released by a decrease in stock in one line

may be used for the heavy stock in other lines. This is especially true in department stores handling a wide variety of lines, in which the high and low stocks fall at different periods of the year. In the larger department stores reporting to the Harvard Bureau of Business Research, the investment in stock varies from 86 in January to 114 in November, based on 100 as the average monthly investment. In specialty stores the investment in stock is 81 in January, compared with 120 in October, which means that in specialty stores about 50 per cent more capital is tied up in stock during October than during January.

If in each department an estimate is made of the monthly sales and purchases, and these estimates are totaled for the store, the essentials of a financial budget will be provided from which the capital requirements for the store as a whole may be estimated each month. A store with a sales volume of $16,000,000 will purchase on the average about $1,000,000 worth of merchandise each month. These purchases are seasonal and should follow the fluctuation in sales volume of the different departments as closely as possible. By planning investments in stock for each department in relation to sales, a store can operate on a narrower margin of working capital, and thus get a higher rate of capital turnover. Figure 21 shows a simple method of planning a store's operations. It is a summary of the total expected cash receipts and disbursements, indicating the necessary amount of cash which must be provided each month from sources other than operations. Although this form is explained in detail later, it is referred to at this point to emphasize the importance, from a financial point of view, of planning the operation of each department so that the activities of the whole store may be coördinated. The major figures to be planned as a guide for the operation of a department are: (1) sales; (2) stocks at the beginning and at the end of the period; (3) per cent of initial mark-up; and (4) per cent of mark-down. From these figures the purchases at cost and retail may be derived.

Planned sales.—The volume of sales which a store or department expects to make during a period governs to a large degree its whole planned operation. It determines the amount of stock which the department can afford to carry, the amount of purchases, and approximately the amount that may be

FINANCIAL BUDGET PERIOD FROM ____ TO ____

			FEB. ~~AUG.~~	MAR. ~~SEPT.~~	APR. ~~OCT.~~	MAY ~~NOV.~~	JUNE ~~DEC.~~	JULY ~~JAN.~~
	RECEIPTS OF CASH							
1	SALES - CASH AND C.O.D.							
2	COLLECTIONS - ACCTS. & NOTES RECEIVABLE							
3	OTHER INCOME							
4	TOTAL CASH RECEIPTS							
	DISBURSEMENTS							
5	PURCHASES (MDSE)							
6	OPERATING							
	RENT							
	TAXES							
	ALL OTHER							
	TOTAL OPERATING DISBURSEMENTS							
7	NOTES PAYABLE							
8	DIVIDEND - STOCK - RETIREMENT							
9	EXTRA ORDINARY							
10	TOTAL CASH DISBURSEMENTS							
	SUMMARY							
11	CASH BALANCE - FIRST OF	ESTIMATE						
	MONTH	ACTUAL						
12	TOTAL CASH RECEIPTS	ESTIMATE						
	(FROM ITEM 4)	ACTUAL						
13	TOTAL	ESTIMATE						
		ACTUAL						
14	TOTAL DISBURSEMENTS	ESTIMATE						
	(FROM ITEM 10)	ACTUAL						
15	EXCESS OF DISBURSEMENTS OR	ESTIMATE						
	CASH BALANCE END OF MONTH	ACTUAL						
16	LOANS REQUIRED							

Fig. 21—Budget of Finances.

spent for the different classes of expenses. This is the reason that most stores plan their sales first and adjust the other planned items to the planned sales figure. In forecasting sales, the first step is to determine the normal rate of growth

of the business; the second, to adjust the estimate for the period that it covers in accordance with prospective conditions in general business, as these conditions affect the particular lines of merchandise; and the third, to make allowances for local or internal conditions which may affect the sales of the department, such as a change in space occupied, an increase or a decrease in the number of lines, and changes in the personnel or organization of the department.

The normal growth in a business from year to year or from season to season is known as its secular trend. This steady change is such as would be caused by the cumulative effect of advertising, increase in population, and the like. This means that a store naturally expects each month to show a certain increase in sales over the corresponding month of previous seasons. The normal increase or decrease in sales from month to month is called the seasonal variation. For example, from previous experience a store may find that 6 per cent of the year's business is done in January, 5 per cent in February, 8.4 per cent in March, and so forth.

In planning sales by months the increase or decrease which each department made in the same month of the previous year must be carefully considered. In the months in which there was only a slight increase or decrease, the percentage of increase ought to be larger than in the months where a large increase was shown over the previous year. In some stores plans are made on the basis of a 10 per cent increase in sales over the same period of the previous year. This method is not only unscientific, but is detrimental to the proper functioning of the merchandise plan. For example, if March of 1923 showed a 10 per cent decrease over the preceding year's figures and a 10 per cent increase is planned for 1924, the planned figure for 1924 would be 99 as compared with 100 for two years previous. If, on the other hand, March showed a 20 per cent increase in 1923 over the previous year and a 10 per cent increase is planned, the index for 1924 would be 132 as compared with 100 for two years ago. In both these instances the secular trend of the department or store should be considered rather than the last year's sales. If the sales of the preceding year are abnormally high, it is not reasonable to plan so high a percentage of increase as when the sales have been normal or when a decrease is shown. In using the

previous year's experience it seems advisable to interpret it to get a secular growth for a department rather than an increase on any particular previous figure. A five-year sales-book is used by some stores to give the normal trend of the department sales. This gives a better basis for planning than the best year's sales or the previous year's sales.

The planned sales should be what is reasonably expected rather than a hoped-for volume. One of the major advantages of planning the merchandise operations is to give serious consideration to the expected business, and the success of such a plan depends to a large degree upon the accuracy of predetermined calculation. Inasmuch as planned sales directly affect the budgeting of operating costs, they should be conservative. In some stores the management deducts a percentage factor of safety from the planned sales before using them in the operating budget. This practice defeats the major purpose of a merchandise plan, which is to lay down beforehand, as nearly as possible, the expected operation of a department or store. The "planned sales for the year" should be a careful estimate, based upon the rate of growth established in previous years, and modified by a study of the immediate situation in wholesale and retail trade, and the internal condition of the department or store. In interpreting previous years' figures for any particular period, the number of days in the week or month should be considered as well as the influence of holidays, such as Easter, Christmas, and other days, which strongly affect the volume of sales.

In addition to previous years' sales the experience of the present year to date should be considered as affected by general economic conditions. If sales for the first half of the year have been 5 per cent behind the same period of last year, as shown by the actual sales of the store itself, the general index of the Federal Reserve Bank, or the sales barometer of the Controllers' Congress, it is not reasonable to plan a normal increase for the second half of the year unless market prospects indicate a break. Similarly, if 12 per cent of a season's sales is normally made in February, 16 per cent in March, and 20 per cent in April, it is reasonable to expect approximately 48 per cent of the planned sales of the season to have been made at the close of April. If, however, 60 per cent of the planned volume for the season has been realized at the

close of the third month, an adjustment may be made for the sales of the three remaining months. Sales should be planned as nearly as possible at a figure which the buyer expects to reach. The forcing of sales to reach a planned figure which has been arbitrarily set, such as beating last year's sales, has resulted in a loss to a great many stores, and in a reaction from undue attempts to get sales volumes, except with a reasonable percentage of maintained mark-up

Another factor which should be considered in arriving at the planned sales figure is the change in the general level of prices, or the average price per unit of merchandise. In the coat and suit department the price level sometimes changes from one season to the next as much as 15 or 20 per cent. In planning the sales volume in dollars this change in price level must be considered, that an accurate comparison of sales by physical units may be made. In order to overcome the effect of changes in price levels some stores plan by pieces, as in the millinery, shoe, and ready-to-wear departments. Some merchants feel that, if the price levels are lower, more people will buy, so the tendency toward lower volume of sales due to lower prices will be compensated by an increase in the number of units sold.

In most departments the amount of the average sale may be used as an index in adjusting sales volume to physical volume. For instance, if the average sale in a department increases from $10 to $12, and the dollar volume of sales remains the same, the actual number of physical units sold has presumably decreased. If, on the other hand, the average sale decreases, the sales volume remaining the same, the sales volume of physical units has increased. In any study of the average sale as a price index, only the corresponding seasons should be compared; thus the same lines of merchandise are included.

Style conditions in the merchandise of the individual departments should also be considered in planning sales volume. The vogue of scarfs which usually accompanies the wearing of suits is an example of the inflation in sales volume which distorts the planned figure for neckwear. In the ready-to-wear department the sales volume may depend on suits one season and on coats the corresponding season of the next year. It is presumed, however, that, whatever the style is, the sales

volume in dollars for the department as a whole may be planned with a reasonable degree of accuracy.

Planned mark-down.—The amount and percentage of mark-down planned for a period depend upon (1) previous experience; (2) merchandising policy; (3) upward or downward trend of prices; and (4) the general condition of the stock on hand, as the result of careful buying and judicious pricing. The mark-down percentage varies with different departments and lines of merchandise and with different periods of the season. Furthermore, the accuracy of the planned figure varies with the nature of the merchandise—whether susceptible to quick style changes and price recessions. Previous experience is the controlling factor in planning the percentage of mark-down for the season as a whole, but, in the adjustment of the appropriation to the different months, the merchandising policy plays an important part. Some stores have a policy of taking no mark-downs until the end of the season, while others attempt to distribute the appropriation throughout the different months. The policy depends upon the type of store and the nature of the merchandise.

The degree of accuracy with which merchandise is priced when it is placed in stock is also an important factor in determining the amount of mark-down. In some stores it is the policy to place merchandise in stock at a price which is higher than any considerable quantity is expected to be sold. The aim is to stimulate purchases by taking mark-down from this fictitious initial price. The tendency at the present time, however, is away from such a price policy, because the practice, among most retailers, is considered unethical. The policy of meeting competitor's prices, or of underselling competitors, very greatly increases the percentage of mark-downs. Another factor which should be considered in planning this figure is the general trend of wholesale and retail prices. In a period of falling prices the amount of mark-down is presumably larger than in a period of rising prices.

The common figure for mark-down in 16 specialty stores reporting to the Harvard Bureau of Business Research in 1923 was 9.4 per cent of net sales. Of these stores, three reported mark-downs amounting to 18 per cent of net sales, and there was only one instance of mark-down amounting to less than 5 per cent of net sales. Department stores with

sales under $1,000,000 had a common figure of 6 per cent of net sales, and those over $1,000,000 a figure of 7 per cent. In the former group there were 23 with mark-downs of less than 4 per cent of net sales and 18 with more than 10 per cent of net sales. In the latter group there were four instances of mark-downs less than 4 per cent and 13 of more than 10 per cent of net sales. In view of the fact that specialty stores, for the most part, deal in women's wearing apparel, which is particularly subject to rapid style changes, it is reasonable that mark-downs should be higher than in department stores which have a smaller percentage of style merchandise.

The following example indicates the method used by a store in planning sales and mark-downs in the millinery department, which is highly sensitive to style changes:

SPRING SEASON; MILLINERY DEPARTMENT

PLANNING THE BUDGET

	Feb.	*March*	*April*	*May*	*June*	*July*	*Total*
Sales, 1919	$5,000	$ 9,000	$ 8,000	$6,000	$4,000	$7,000	$39,000
Sales, 1920	4,000	10,000	6,000	6,000	4,000	3,300	33,000
Sales, 1921	3,100	8,000	5,000	6,200	4,500	3,200	30,000
Sales, 1922	4,000	8,000	7,000	6,500	5,000	4,000	34,500
Estimated sales, 1923	5,000	12,000	11,000	7,500	6,000	4,500	46,000

1. Factors used in determining planned sales:
   1. Previous years' experience.
   2. Present physical conditions in the department.
   3. General economic conditions.
   4. Merchandising methods in the department.

2. Turnover by months, budgeted by past experience, attainments of most successful departments in our Federal Reserve district, and experience of member stores in the association.

	Feb.	*March*	*April*	*May*	*June*	*July*	*Total*
Turnover	1x	1½x	2x	1½x	1½x	1½x	9x
Planned stock (first of month)	$5,000	$8,000	$5,500	$5,000	$4,000	$3,000	

$\frac{\text{Sales}}{\text{Stock}} = \text{Turnover}$. Conversely, $\frac{\text{Mo. Sales}}{\text{Mo. Turn.}} = \text{Planned stock (first of month)}$.

3. Mark-down appropriations, experience shows us, for the season, should total 8 per cent of the total planned sales. The mark-downs, if taken at the right time, will speed the turnover. The rapid turnover permits these mark-downs.

Arbitrary Distribution of Mark-downs Appropriate for a Spring Season.

February, no mark-down, because the stock is new to start the season. All depreciation on undesirable merchandise in stock should have been charged off in January, so the losses will appear on Income Tax Statement. There is little or no hazard from style fluctuation during February.

March, 1/12 of total mark-down appropriation. This should cover losses incident to sampling new styles, when the season's styles have not yet been decided upon. We profit from this method of determining style tendencies in advance, as the results more than compensate for the losses through mark-downs as the result of sampling.

April, 1/3 of total mark-down appropriation, as Easter is the peak of the season for spring style; subsequent to Easter the style market suffers a sharp decline. The spring millinery and ready-to-wear must be cleaned out immediately after Easter. Our experience indicates that the higher-priced merchandise moves less rapidly after Easter than before. The appropriation for April is provided for, because some mistakes in buying are unavoidable. Manufacturers have realized the same market conditions and are offering pre-Easter merchandise at lower prices than we had to pay prior to Easter. If we do not merchandise carefully and operate with minimum stocks, there is frequently a dangerous reaction from competitors who buy the manufacturers' mark-downs after Easter. Money can be made in April by retailing special purchases, but these opportunities cannot be capitalized if the department is loaded with pre-Easter stock.

Planned sales for April..................	$11,000
Planned stock for April 1................	5,500
Turnover	2x

If 1/3 of mark-down appropriation equals 10 per cent of sales, the percentage would allow for a reduction, on an $11,000 stock, the equivalent of 20 per cent, or 2 × 10 per cent of the sales, as a price reduction on the stock.

May, 1/12 of total mark-down appropriation, as this mark-down is the result of sampling summer styles and sport models. The stock should have been cleaned of all spring models.

June, 1/3 of total mark-down appropriation, as this is one of the months in the spring season for largest mark-downs, the remaining summer models must be priced positively to move them. On July 1 the stock should be clean, that moderate-priced fall models may dominate.

July, 1/6 of the total mark-down appropriation; this being the final month of the season, a positive clearance is necessary because of the tremendous depreciation that has actually occurred and to make room for fall stock. July 31 should find the stock ready to receive larger amounts of fall merchandise.

Now, our mark-down budget appears as follows:

	Fractional Part	*Total Mark-downs*
February	*None*	*None*
March	1/12	306
April	1/3	1,225
May	1/12	306
June	1/3	1,225
July	1/6	614
8 per cent..................		3,680

Planned stock.—The amount of stock which is necessary to maintain a planned volume of sales depends upon the nature of the merchandise, and the time element of delivery. By past experience most stores set up a ratio between sales and stock at the beginning or the end of each month. By dividing the ratio into planned sales, the planned stock is determined. A model stock consists of a complete assortment of merchandise as to price lines, style, size, and color, in direct proportion to the planned sales of the individual items. Merchants have found it advisable to take a stock analysis periodically in order to eliminate slow-moving items and to refill incomplete lines. Through past experience a buyer of seasonal merchandise should evolve a selling calendar, showing the date of the first display opening, the beginning and the end of mass selling, the break in wholesale and retail prices, and the end of the season. In some lines of merchandise with a season of from 12 to 16 weeks, there is a definite revision of prices in the seventh or eighth week. With the development of systematic merchandise planning, these dates have become more definitely fixed, consequently a buyer may anticipate with a reasonable degree of accuracy the periods at which stock should be adjusted. The following is an example of the factors which one store considers in planning and adjusting stocks to the various months in the ready-to-wear department for the spring season:

There are four major factors which contribute to the success or the failure of the ready-to-wear department. In the first place the general economic condition of the community very greatly affects the volume of business done in certain lines of ready-to-wear. Prosperity directly affects price lines and volume of business. A slump in business affects the ready-to-wear business, inasmuch as people can always make their old clothes do, whereas they must have the absolute necessities. The next factor is the possibility of quick style changes which will leave stocks of undesirable merchandise and small purchasing power for the new style development. A third important factor is the possibility of quick price change and sudden breaks in the market, caused by reduction in the cost of the material, labor, or because of surplus stock unloaded by manufacturers and wholesalers. Stocks are worth only the price at which they can be duplicated. Weather is always an

important factor which contributes to surplus stocks and resultant price readjustments. Although no definite schedule can be applied to individual departments, there are some general seasonal conditions existing with reference to buying activities and stocks that apply to specific months and serve as a guide in adjusting the stocks to these conditions.

During the month of February the buyer should clear out winter stocks and show early purchases of new merchandise. This is not a logical buying month, and nothing can materially affect the ready-to-wear business during this period. In March, however, a buyer should get a large volume of business. He should study sales closely during the first two weeks to guide in reordering and buying for April. A price break or change is very unusual in this month and style changes seldom appear so early in the season. On the first of April it is desirable to have as low a stock as possible in ratio to sales, as price changes are very apt to prevail immediately following Easter. In order to take advantage of lower prices, stock should be in a condition to allow liberal purchases at this time. This is particularly true of the coat and suit business. Cotton and light summer silk are being purchased at this time. The blouse, sweater, skirt, and dress departments will not be much affected during this month, as they are being built up for summer business. The main business in coats and suits depends to a large degree upon development of something new in these lines.

By May 1, the coat and suit stocks should be low and clear, if the department has been properly merchandised. A few coats and suits will be sold during May, but, as a rule, it is beginning to get warm and customers are shopping for dresses. The dress, blouse, and skirt stocks should be liberal and new, and the dress stock should be built up to the season's peak, which is usually about June 1. The business of May is very greatly affected by the weather. If it gets warm the spring business will open much quicker than if this month is cold and rainy. During this month the buyer should be on the lookout for any style change in dresses. Suit and coat stocks should be at their lowest point of the season on the first of June and the blouse, dress, skirt, and sweater departments should be at their peak, inasmuch as a large volume in business should be done in these summer departments between June 1 and July

4. The business of June, to a large degree, is determined by the judgment of the buying organization.

Weather has an important effect on summer business. A very cold June will reduce greatly the volume of summer dresses and bathing suits, but, on the other hand, it does not seem to increase the coat and suit volume. July is a clean-up month of summer stock. Price adjustment comes immediately after July 4. Cotton dresses, skirts, and other summer apparel can be secured at considerable reductions. By the end of July there should be small assortments of fall apparel in stock. The geographic location of the store is an important factor in determining the amount of fall business done in this month.

Initial mark-up.—The planned percentage of initial mark-up depends upon: (1) department overhead; (2) percentage of mark-downs and inventory shrinkage expected; (3) number of turnovers; (4) competition; and (5) the merchandise policy. By past experience the expense of operating the different departments is determined. The percentage allowed for mark-down and inventory shrinkage is also based upon past performance. As a general rule, the margin of initial mark-up decreases with an increase in the rate of stock turn, due to the fact that the merchandise remains in stock a shorter period, thus decreasing the overhead and the liability of mark-downs. The following procedure in planning initial mark-up is common among stores that draw up an accurate merchandise plan sheet:

After securing the first estimated total expense from the controller's office and adding to this amount the net profit desired, the minimum gross margin which will cover both of these items is determined. The per cent of sales that may be allowed for mark-downs at retail is next determined, taking into consideration the nature of merchandise handled, the size of stock on hand, the rate of turnover, and previous experience. To get the allowance in dollars for mark-downs at retail for the season, multiply planned season's sales by the per cent of mark-downs allowed. The percentage of inventory shrinkage at retail allowed for the season is determined entirely by previous experience, taking into consideration errors in measurement, theft, and clerical mistakes. By applying the percentage to planned sales, the allowance in dollars is found for shrinkage. The total mark-up in dollars is found

by adding together the planned gross margin, mark-down, and inventory shrinkage. The average initial mark-up percentage required on retail is found by dividing the planned mark-up in dollars by the sum of the planned sales for the season, the planned allowance in dollars for mark-downs, and the planned allowance for inventory shrinkage.

Thus, if the planned net sales of a department are $10,000, the percentage of expense 27, net profit desired 5 per cent, the mark-down planned 6 per cent, and the inventory shrinkage 1 per cent, the total initial mark-up would be $3,900 which, divided by $10,000 + $600 + $100 gives 36.4 per cent, the planned initial mark-up percentage.

Another factor affecting the percentage of initial mark-up is competition, which tends to maintain a uniform level of retail prices for similar lines of merchandise. Under the present competitive commercial system, the retail price of an article is determined, to a large extent, by the general practice of the trade. This is especially true in lines of merchandise which are branded or which have characteristics that are comparable in different stores. Although supply and demand play an important part in determining the retail price, the individual store must correlate its prices with those of other stores. The fifth and final factor determining the initial mark-up is the merchandising policy of the store. In exclusive shops the initial mark-up is necessarily higher than in popular-priced stores. Stores handling highly seasonal merchandise, such as women's wearing apparel, which is peculiarly subject to style changes, must necessarily plan a high initial mark-up because of subsequent large mark-downs. The initial mark-up is adjusted to months and to individual items according to past experience and market conditions.

Plans used by stores.—Although the principles of merchandise planning are essentially the same throughout the whole retail field, their application in individual stores shows a wide variation both as to the figures planned and the method of arriving at these figures. The plan shown in Figure 22 is used by a department store located about one hundred miles from New York City. This form provides space for last year's actual figures, the plan for this year, the results of this year by months, and the total for the season. The items planned by this store are: (1) sales by month; (2) rate of

stock turn for each month of the season; (3) per cent of mark-up on purchases for the season; and (4) per cent of mark-down to sales by months. The other items on the plan

MERCHANDISING PLAN

DEPT. 24

Spring SEASON. 1924

MONTH	FEBRUARY / AUGUST	MARCH / SEPTEMBER	APRIL / OCTOBER	MAY / NOVEMBER	JUNE / DECEMBER	JULY / JANUARY	TOTAL OR FINAL
SALES LAST YEAR	2,207.00	3,666.00	4,321.00				
PLAN THIS YEAR	2,428.00	4,033.00	4,753.00				
RESULT THIS YEAR	2,781.00	4,311.00					
MARK DOWNS LAST YEAR	37.00	172.00	194.00				
PLAN THIS YEAR	73.00	120.00	142.00				
RESULT THIS YEAR	60.00	198.00					
RETAIL STOCK (1st of Mo.) LAST YEAR	17,695.00	20,923.00	21,032.00				
PLAN THIS YEAR	18,677.00	21,227.00	21,605.00				
RESULT THIS YEAR	18,509.00	21,576.00	21,147.00				
COST STOCK (1st of Mo.) LAST YEAR	11,643.00	13,767.00	13,839.00				
PLAN THIS YEAR	12,140.00	13,798.00	14,043.00				
RESULT THIS YEAR	12,170.00	14,186.00	13,904.00				
RETAIL PURCHASES LAST YEAR	5,472.00	3,947.00	2,544.00				
PLAN THIS YEAR	5,051.00	4,531.00	3,347.00				
RESULT THIS YEAR	5,908.00	4,080.00					
COST PURCHASES LAST YEAR	3,626.00	2,701.00	1,607.00				
PLAN THIS YEAR	3,283.00	2,945.00	2,176.00				
RESULT THIS YEAR	3,855.00	2,668.00					
% M. U. ON PURCHASES LAST YEAR	33.74	31.57	36.85				
PLAN THIS YEAR	35.00	35.00	35.00				
RESULT THIS YEAR	34.75	34.61					
% MARK DOWNS LAST YEAR	1.68	4.69	4.49				
PLAN THIS YEAR	3.00	3.00	3.00				
RESULT THIS YEAR	2.20	4.60					
TURNOVER SIX MO. LAST YEAR							
PLAN THIS YEAR							
RESULT THIS YEAR							

Fig. 22—Merchandising Plan.

sheet are arrived at through computation. Cost of stock is found by applying the complement of purchase mark-up (100-35) to the retail stock. Thus, for February, the planned

cost of stock is found by taking 65 per cent of $18,672. The amount of mark-down is found by applying the planned per cent of mark-down to planned sales.

The amount of planned retail purchases for each month is the sum of the planned sales and the planned mark-downs for the month, plus or minus the planned change in the retail stock. Thus, planned purchases for March are found by adding together planned sales $4,033, planned mark-down $120, and the increase in stock during the month of March $21,605 — $21,227, or $378. The planned retail purchases, reduced by the sum of the planned per cent of mark-up and transportation costs, gives the planned purchases at cost. After the plan sheet is made out the operations of the department for the season are summarized by totaling the monthly operations. This type of merchandise planning has an advantage over that of simply setting a quota for the season, because it gives six mile-posts by which the buyer may check up on his operation. If he fails to make his season's quota, the six-months plan will indicate at what place he has fallen behind. If the totals of the six-months planned operations do not give a satisfactory seasonal quota, the figures may be adjusted for the individual months.

Merchandise planning by weeks.—In some stores the week is made the unit of time for the planning of all merchandise activities. It is felt in these stores that adjustments in the merchandise plan may be made more easily, if actual performance is compared with planned figures four times a month. The form shown in Figure 23 is used by one of the largest stores in New York City as the weekly basis of its merchandise plan. In this store the figures for the past two years are filled in by the statistical department; the sheet is then sent to the buyer who fills in the planned figures. Purchases and stock are planned at cost, sales at retail, and marking and reductions in per cent of sales. To the controller this form provides information weekly, showing the amount of money each department plans to spend, the stock investment, the approximate gross margin, or maintained mark-up, and the sales or income. If the planned sales figures are reached or an increase is shown, the columns headed "marking per cent to date" and "reduction per cent to date" will show whether sales have been forced by a low purchase mark-up or a high

per cent of reductions has been taken. Either of these conditions will affect net profit.

Although the planned and actual marking and reduction per cent is not shown for the week, their relative size may be approximated by their effect on the cumulative per cent to date. The column "sales increase or decrease per cent to date" gives the buyer and controller a cumulative figure, showing the relation between this year's and last year's sales. Thus the form not only gives planned figures, but shows currently the relation between actual performance and planned performance. By subtracting the "reduction percentage to date" from

MERCHANDISE PLAN
SPRING 1924

	PURCHASES (COST)				MARKING % TO DATE				SALES						Per Cent to Date	REDUCTIONS % TO DATE				STOCK (COST)			
	1922	1923	1924 Planned	1924 Actual	1922	1923	1924 Planned	1924 Actual	1922	1923	1924 Weekly Planned	1924 Weekly Actual	1924 To-Date Planned	1924 To-Date Actual	Inc. & Dec.	1922	1923	1924 Planned	1924 Actual	1922	1923	1924 Planned	1924 Actual
FEB. 9																							
" 16																							
" 23																							
MAR. 1																							
MAR. 8																							
" 15																							
" 22																							
" 29																							
JUL. 5																							
" 12																							
" 19																							
" 26																							
AUG. 2																							

Signed ______________ Dept. Manager
Approved ______________ Merchandise Controller

Fig. 23—Merchandise Plan.

the "marking percentage to date" the current gross margin is shown. This provides an accurate weekly check on the profit-making ability of the buyer. Furthermore, it provides a weekly barometer for the buyer, showing him whether or not he is making satisfactory progress toward planned sales, and planned maintained mark-up. This form, supplemented by the buyer's weekly report, gives the necessary statistical information properly to guide the buyer in his merchandising activities.

Open-to-buy.—Open-to-buy is a term used to indicate the amount of money remaining to be spent for merchandise for a given period according to the merchandise plan. It is found by subtracting the sum of all merchandise received and ordered for delivery during a period from the adjusted purchase limit as entered on the merchandise plan. Thus, if a

buyer plans to sell $10,000 worth of merchandise, to take $500 mark-downs, and to have $1,000 more stock at the close of the period than at the opening, he will presumably be open-to-buy merchandise to the amount of $11,500 at retail. A more detailed application of the procedure in arriving at the open-to-buy may be made by using the following data representing the conditions of a department on March 1.

Planned stock February 1	$10,000
Planned sales February	5,000
Planned purchases February	6,000
Planned purchases March	7,000
Planned mark-downs February	500
Actual stock February 1	11,000
Actual sales February	4,500
Actual purchases February	5,500
Actual mark-downs February	600
Mark-up 36 per cent.	

The planned figures given above are taken from the merchandise plan and from the actual record of operations of the department. The planned purchases for March are $7,000, but, because of the variation from the plans in February, it is necessary to make an adjustment. The department presumably purchased $500 less in February and had $100 more mark-down than was planned. On the basis of these figures the planned purchases for March would be increased $600. But the actual sales for February were $500 less than the planned sales, and the stock at the beginning $1,000 more than the planned figure, making a total of $1,500 by which the planned purchases of March would be decreased. Thus the adjustment is $600 upward and $1,500 downward, making a net decrease of $900 which, subtracted from $7,000, gives $6,100 as the adjusted purchase limit for March. With a mark-up of 36 per cent, the planned purchases at cost would be $3,904.

The open-to-buy report (Fig. 24) shows a very simple method of making adjustments due to variations from planned figures. The planned purchases are taken directly from the merchandise plan sheet and adjusted by the increase or decrease in sales or reductions, giving "planned purchases adjusted." The total of receipts to date and outstanding orders, subtracted from adjusted planned purchases, gives the

Dept. #........

The Open-to-buy Report as of April 17th shows the following:

Month	*Planned Purchases*	*Sales Increase or Decrease and Re-ductions (at Cost)*	*Planned Purchases Adjusted*	*Receipts to Date*	*Out-standing Orders*	*Total*	*Open to Buy*
April ...	27,000	1,000	26,000	10,500	5,000	15,500	10,500
May ...	23,000				4,500	4,500	18,500
June ...	18,000				2,650	2,650	15,350
Total ..	68,000						

Fig. 24—Open-to-buy Report.

open-to-buy for the remainder of the period. Another method of figuring the open-to-buy is shown by the following formula:

1.	Planned end-of-the-period stock	$10,000
2.	Planned retail deductions for the balance of period (sales and mark-downs)..............	4,000
3.	Total	$14,000
4.	Stock on hand at present.......................	7,000
5.	Outstanding orders to be delivered this period..	1,000
6.	Total	$ 8,000
	Open-to-buy (difference between 3 and 6)......	$ 6,000

How to increase the open-to-buy.—Under normal conditions, with a properly planned stock, a department should be open-to-buy to the end of the period. However, in the actual operation of a department, conditions arise which make it necessary for the buyer either to purchase more merchandise than his plan calls for or to adjust his planned figures so as to increase his open-to-buy. By increasing the planned-sales figure the open-to-buy is automatically increased. For instance, if on the fifteenth of the month the sales are 10 per cent above the amount anticipated for that date, the planned sales for the entire month may be increased, which will necessitate an

increase in purchases. An increase in the planned end-of-the-month stock will also increase the open-to-buy. When sales are running above the planned figure the buyer may wish to increase his stock so as to maintain the same ratio between sales and the stock at the end of the month. Taking more mark-downs than the planned amount tends to increase the open-to-buy in exactly the same way as increasing the planned end-of-month stock. Increased mark-downs tend to stimulate sales, which may also result in an increased open-to-buy.

Inasmuch as the open-to-buy depends upon the amount of orders already placed for delivery during a period, it may be increased by canceling merchandise for that month's delivery and redating it to a following month, thus making possible the placing of orders for other merchandise to be delivered during the period. This procedure is very often used to the mutual advantage of both buyer and seller, inasmuch as it is often more advantageous for the seller to make a later delivery. Returning merchandise, such as memorandum merchandise, charged into stock, has the same effect upon open-to-buy as an increase in the amount of mark-downs or end-of-month stock. A final method of increasing open-to-buy is to prove an actual stock shortage and get an adjustment before the end of the period. The book inventory of stock at the middle of a season is presumably higher than the actual inventory by an amount equal to one-half the average stock shortage for the season.

Operation of merchandise plan.—In the operation of this type of purchase control, it is necessary, first, to make certain that the purchase control division secures a record of all orders that are placed with manufacturers and all receipts of merchandise. In the operation of the plans outlined above, all merchandise purchase orders should be routed through the merchandise control section. When a department has an open-to-buy balance, the orders are entered on the open-to-buy work sheet, as shown in Figure 25, and signed or stamped by the purchase-control clerk. When a department has no open-to-buy, or is in an overbought condition, the orders, with a statement indicating this condition, should be referred to the merchandise office for disposition. Should the merchandise office decide to pass the orders, its approval should be secured before putting the orders through the control.

The success of a merchandise plan or budget depends largely upon three major factors:

1. The accuracy of the predetermined calculation.
2. The elasticity of the budget to meet changing conditions.
3. The facility with which adjustments are made when the actual operation discloses deviation from the original plan.

Inasmuch as a merchandise plan is to guide rather than to control, provisions must be made for additions to, and deduc-

OPEN TO BUY WORK SHEET
DRESS GOODS DEPARTMENT No. 27
Month of April, 19'

SPRING SEASON	FEB.	MAR.	APR.	MAY	JUNE	JULY	TOTAL
1 Planned Cost Purchases			2,176	965	880	269	4,290
2 Variation of Cost Stock from Plan			139	....	....	....	139
3 Net Planned Cost Purchases			2,315	965	880	269	4,429
PURCHASE LIABILITY							
4 Merchandise in Transit			620	....	....	....	620
5 Unfilled Orders			785	125	100	....	1,010
6 Total			1,405	125	100	....	1,630
Orders Placed Day April 1							
2			200	....	....	....	200
3			....	150	....	....	150
4			50	....	....	....	50
5			125	80	....	....	205
6			75	....	....	....	75
7			100	20	....	....	120
(Total) 8			1,955	375	100	....	2,430
9							
31							

Fig. 25—Open-to-buy Work Sheet for Dress Goods Department.

tions from, the established limits. In some stores it is felt that generous estimates of sales and correspondingly high limits for purchases should be encouraged. They feel that a buyer will work harder if his planned performance is high. In actual practice, however, it is found that too much optimism in planning leads to extravagance and loss. On the other

hand, restriction upon legitimate increases in expenditure for merchandise retards normal growth and expansion. The plan must be made to expand and contract with the immediate demands of the business.

A merchandise plan, to be successful, provides not only for adjustments, but the current information for making the adjustment, so that the actual merchandise activities will not be retarded by the planned limits. One of the chief obstacles in the introduction and operation of a merchandise plan is the feeling on the part of the buyers that it will retard their activities and freedom in the management of the department. The form, shown in Figure 26, provides a simple means of sys-

REQUEST FOR REVISION OF PLANNED FIGURES

FOR DEPT.__________ DIV.__________

MR.__________ (DATE)__________192___

I HEREBY REQUEST REVISION OF THE PLANNED FIGURES FOR THIS DEPARTMENT AS FOLLOWS:

GENERAL CLASS OF ITEMS IN WHICH REVISION IS REQUESTED (PURCHASES, SALES, ADVERTISING, SALARIES, &C., &C.)	MONTH FOR WHICH REVISION IS REQUESTED	PRESENT PLANNED FIGURES	PROPOSED PLANNED FIGURES	INCREASE OR DECREASE	STATEMENT OF NECESSITY FOR REVISION IN PRESENTING YOUR CASE DON'T BE GENERAL IN YOUR ASSERTIONS. BE SPECIFIC. SHOW THE FACTS AND STATE THEM CLEARLY. WANT OF CARE CAUSES MORE LOSS THAN WANT OF KNOWLEDGE.
TOTAL					(USE OTHER SIDE FOR FURTHER REMARKS)

SIGNED__________ BUYER OR HEAD OF DEPT.

APPROVED__________ DIVISIONAL MDSE. MGR.

PASSED__________ 1st VICE PRES.

Fig. 26—Request for Revision of Planned Figures.

tematically adjusting the figures on the merchandise plan. In making a request for revisions of planned figures, the buyer must state the changes in conditions which have made necessary a deviation from the original plan. This plan of making adjustments is particularly advantageous, in that it emphasizes the necessity of careful initial planning on the part of the buyer.

The work of making the plans usually begins about two months before the end of the preceding season. Although there is no standardized practice as to when the seasons should

begin and end, most stores close with July and January or with August and February. The keeping of all records and the preparation of forms pertaining to merchandise control should be the function of the controller. These records include the tabulating of merchandise purchases and orders from which the department's open-to-buy is determined. The sources of this information are the inventory at cost and retail at the beginning of each period, the purchases as recorded in the purchase-control office, the debit memorandum for merchandise returned to the manufacturer, the departmental transfers, the record of all price changes as shown on the mark-up and mark-down sheets, the net sales record, and the inventory at the end of the period.

Merchandise plans should originate with the buyer working in conjunction with the merchandise manager. The controller acts from the financial standpoint to see that the plans are reasonable and that the final figures bear the proper relation to each other. The last year's figures should be filled in by the statistical department in the controller's office. It is felt that, if the buyer does the actual planning, he will not only better understand the plan, but will have a higher sense of responsibility in seeing that it is carried out.

As a general rule, the idea of definitely planning the merchandise activities of a store has originated with the controller or merchandise manager. In a great many instances the routine of planning has been thrust upon the buyer, without any general knowledge on his part that the plan is primarily for his use. A merchandise plan of this kind will never be successful. If, however, the major function of planning is performed by the buyer, the merchandise manager and controller acting only as advisers, a maximum of merchandising efficiency will result. Although merchandise planning has been in use for several years in some department stores, it is comparatively new to most retail institutions and has been adopted by few.

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Problems.

1. The Marsh department store does an annual business of approximately $15,000,000. The total sales for the toy department for the last half of 1923 were $135,431. Although the merchandise manager is satisfied with the volume of sales for the toy department, he feels that the rate of stock turn is not high enough. In order to increase the rate of stock turn the buyer was asked to draw up a merchandise plan for the fall season of 1924. As an aid in drawing up this plan the merchandise manager sent the following memorandum to the buyer:

Elements which must be considered in planning stocks and purchases for the toy department, fall season, 1924.

The toy department is unique in that in one month, December, nearly as much business is done as in the other eleven months of the year together. This condition necessitates accumulating stocks that will accommodate the demand during the early fall months, and yet be sufficient for the Christmas season when it begins.

In accumulating the large stock for the Christmas season, there are several factors which govern the time of delivery of merchandise and hence the size of the stocks necessary to carry each month. These are:

a. The desire of manufacturers is to ship during the summer and early fall in order to clear their warerooms and make way for later deliveries and also to get early payments to finance the business. On all early shipments, an October 1 dating is given, and sometimes one per cent per month is allowed for anticipation.

b. The time required for receiving, marking, sorting, and putting in reserve in the stock room is considerable.

c. The delivery date must not be specified too late in the season to insure delivery in time.

d. Merchandise must not be brought in any earlier than absolutely necessary, because interest charges pile up on a big stock carried over too long a period, and turnover is decreased.

e. The delivery date of foreign merchandise must be much earlier than that of domestic merchandise, since it takes longer to receive and to mark. The stock in the early fall months of last year was much higher at the start than should be planned for this year, because of the $27,000 worth, at landed cost, of imports. This year so little foreign merchandise is coming in that it need not be considered as affecting the

stocks in an unusual way. The foreign merchandise received in 1923 caused our stocks to be generally higher throughout the season than will be desirable this fall.

In 1923 there was about $1,000 of winter merchandise carried over as well as $1,000 of character dolls and other slow-moving stock, really Christmas merchandise, which accounted, in part, for the size of the stock on July 1 of $24,580. This year our July 1 stocks should be considerably smaller, although the "Wee Book Shop" requires a much larger stock than the book stock carried last year.

In planning for the September stock, it must be remembered that $1,500 worth of merchandise at cost must be brought in for the Anniversary Sale.

The closing stock at the end of December, 1923, was too low, due to heavy reductions taken to clear out unsalable merchandise which had to be disposed of at that time.

The heavy foreign stock had two counteracting effects on the sales:

a. The heavy reductions accelerated sales in the latter part of December.

b. This heavy stock of relatively slow-moving merchandise prevented the purchase of more desirable, faster-moving domestic merchandise on which a greater profit could have been realized.

It is believed that this year the sales should be approximately the same in amount as last year.

The stock should be somewhat lower than last year, but well-assorted by November 10 when the department opens for Christmas business.

It is necessary to have considerable purchasing power in December to fill in on the best-selling lines and to take care of special orders. Last year only the barest necessities were bought.

PLAN AND EXPERIENCE SHEET

Department of Toys and Sport Goods

Planned stock—July 1, Actual $15,000

Fall Season 1924	*Sales*				*Purchases Cost*			
	Cost Last Year	*Retail Last Year*	*Planned Retail This Year*	*Actual Retail This Year*	*Last Year*	*Planned This Year*	*Plan Adjusted*	*Actual This Year*
July	$ 3,000	$ 4,939			$ 8,845			
August	3,800	6,308			11,726			
September ..	2,700	4,566			14,851			
October	5,200	8,630			27,679			
November ..	11,600	19,298			14,072			
December ...	55,000	91,700			7,000			
Total	$81,300	135,431			84,173			

Stock

Cost—End of Month

	Average	*Last Year*	*Planned This Year*	*Actual Thist Year*
July		$30,189		
August		36,535		
September ...		48,689		
October		71,120		
November ...		72,578		
December		11,800		

With this background you will be expected to fill in, on the above "Plan and Experience" form, the planned sales at retail, the planned stocks at cost, and the planned purchases at cost. (Planned purchases are derived from the planned stocks at cost and the sales of last year at cost in the manner described above for retail figures.)

2. Below is a copy of the "open-to-buy" report sent weekly to each department in the Marsh department store. In the first column is given the amount of planned purchases which is taken from the "plan and experience" sheet. The problem is to determine how much this department is open-to-buy under the following conditions:

a. The sales at retail are two thousand dollars ($2,000) less than for the same period (the first 17 days) of April last year. This means that the planned purchases at cost must be reduced accordingly.

b. The reductions to date this month have been $500 at retail more than planned. Since the stock at the end of the month will be decreased by that amount, the department should be allowed to increase its purchases at cost accordingly.

c. The mark-up of the department is 33⅓ per cent.

d. The receipts of merchandise so far this month have been $10,500 (at cost).

DEPARTMENT No. 2

The Open-to-buy Report as of April 17

Month	*Planned Purchases*	*Sales Increase or Decrease and Reductions (at Cost)*	*Planned Purchases Adjusted*	*Receipts to Date*	*Outstanding Orders*	*Total*	*Open to Buy*
April	$27,000						
May	23,000						
June	18,000						
Total ..	$68,000						

e. The outstanding or unfilled orders for delivery yet this month are $5,000 at cost. For May the outstanding orders are $4,500, and for June they are $2,650, both at cost.

With these data, complete the report on page 212 and show in the right-hand column the amount the department is "open-to-buy" for this month, for May and for June.

3. The following data (all figures at retail) represent the condition of the dress department in a store on March 15:

Planned stock, April 1	$40,000
Planned sales, March	35,000
Planned mark-downs, March	2,000
Actual sales, March 1-15	15,000
Actual mark-downs, March 1-15	750
In stock, March 15	45,000
On order, March 15 for March delivery	35,000

How much was the dress department open-to-buy for the balance of March?

4. The buyer of millinery in the Hale department store had the following plan for the spring season of 1924:

	Feb.	*March*	*April*	*May*	*June*	*July*	*Total*
Planned sales	$4,000	$8,000	$7,000	$6,500	$5,000	$4,000	$34,500
Planned stock turn (sales for the month divided by stock as of the first of the month)	1	1½	2	1½	1½	1½	
Planned mark-down (fraction of total)	none	1/12	1/3	1/12	1/3	1/6	8%

What should be the planned purchases at retail for each of the six months?

Chapter IX

CONTROL THROUGH DEPARTMENT SUBDIVISION

The control by dollars of the merchandising operations of a store or a department is the first essential in bringing about the proper relation between stocks and sales. Such control, however, does not analyze the operation of a department in sufficient detail to determine the ratio between the sales and stocks of particular lines of merchandise. The principle of merchandising is not so much that the merchant should have a small investment in relation to sales, but that this investment should be in the lines which are selling. For instance, in a departmental analysis shown in Table 22, the rate of stock turn for the department as a whole was 5; whereas, the different lines show turnovers varying from 3.4 to 16. A departmental plan may show advantageous ratios of stock to sales for the department as a whole, but the heavy investments may be in lines which are slow-moving and vice versa. In one instance an investigation in a department showed that 75 per cent of the sales for a six-months period were made on 20 per cent of the stock.

The most ideal type of control is that in which the individual units are planned, so that each item is found in stock in proportion to sales. This is called a perpetual piece control and is used by stores where the merchandise units are large and individual, as in the ready-to-wear, furniture, rug, and carpet departments, or where the items, though small, may nevertheless be grouped for control purposes into larger units, such as certain lines of notions, toilet goods, and house furnishings. Many stores feel, however, that a perpetual piece control is impracticable in a large number of departments carrying smaller units, because of the expense entailed in keeping the records in a current condition, so that they may aid in the operation of the department rather than as an analysis of past performance.

Subdivision of departments.—A second possibility of obtaining current records by lines is to establish a running stock by subdivisions of departments. To do this requires an analysis by departmental subdivisions and a separate audit of purchases, sales, price changes, and stocks.

TABLE 22

SALES, STOCKS, AND TURNOVER BY CLASSIFICATIONS

Classification Number	*Average Stock*	*Sales*	*Rate of Turnover*
1	$25,000	$120,000	4.8
2	13,000	56,000	4.3
3	12,000	58,000	4.8
4	8,000	40,000	5.0
5	2,000	32,000	16.0
6	6,000	28,000	4.6
7	5,000	26,000	5.0
8	4,000	18,000	4.5
9	5,000	17,000	3.4
10	2,000	15,000	7.5
11	3,000	14,000	4.6
12	2,000	13,000	6.5
13	1,000	10,000	10.0
14	1,000	8,000	8.0
15	2,000	7,000	3.5
Total	$91,000	$462,000	5.0

Merchants, as a rule, are reluctant to establish control in units smaller than the whole department, because of the expense involved. The equivalent of this information may be secured, however, by establishing a control over net purchases and price changes by classification or department subdivisions. The first step in the operation of this type of merchandise control is definitely to establish the subdivisions or merchandise classifications within the department. The number of such classifications will vary according to the nature of merchandise handled, the divergence in rate of stock turn, mark-up, and need for individual analysis. For instance, in the women's dress department the subdivisions are usually wool dresses, silk dresses, cotton dresses, and evening and dinner gowns. A subdivision of this kind provides a means of visualizing the conditions of a department as to stock and sales, and allocates profit or loss to particular lines. It involves an individual study in each department, to determine what divisions are

necessary to provide sufficient analysis for the purpose of control.

It is important, in making these classifications, to follow, so far as possible, the same principles that were followed by the Controllers' Congress in drawing up the standard classification of accounts, that comparisons between stores may be made by lines as well as by departments. This is especially important for a group of stores within an association in which more detailed comparisons are made. Associated stores find it advantageous to make the major classification the same, that comparison may be made between all members, leaving more detailed classification to be adjusted to suit the individual departments.

The standard classification of one association provides for 69 departments and 485 subdivisions, an average of 7 in each department. The actual number of subdivisions varies from 3 to 16 in the different departments. The subdivisions of 12 departments, shown on page 217, taken from the standard classification which is used by this association, show the general characteristics of the divisions in a few representative lines.

The operation of these 485 subdivisions as individual departments would entail a separate audit of all purchases, sales, returns, and price changes. In addition it would necessitate the use of 485 sales books or department numbers and would very greatly increase the difficulty in distributing salespeople among departments. The cost of operation in comparison with the savings resulting from departmental subdivisions must determine the number of subdivisions which a store should make. The savings resulting from a control by subdivisions lies in the ability to concentrate on fast-moving lines and to decrease investment on slow-moving merchandise. In other words, to set up a relation between stock and sales by lines rather than by departments. This principle of merchandise control is used effectively by some chain-store systems in which all merchandise is charged to the unit stores at retail and inventories taken at the same figure. Sales by lines or individual items are then found by subtracting stock on hand at the end of the period from stock at the beginning plus purchases. In the smaller stores, carrying several lines of merchandise, it is not practicable to keep a separate audit of the sales of the different departments or lines. In these stores the

DEPARTMENT SUBDIVISIONS

Women's Dresses

Wool
Cotton
Silk evening and dinner

Women's Shoes

High
Low
Slippers
Rubbers
Tennis
Findings
Ornaments

Furniture

Dining room
Bedroom
Living room
Separate tables
Separate chairs
Bookcases
Novelties

Men's Shoes

Men's high shoes
Men's low shoes
Boys' high shoes
Boys' low shoes
Sport shoes
House slippers
Rubbers, leggings
Findings

Books

Popular fiction
Classics
Religious goods
Juvenile books
Commercial books
Biographies, essays, and travel books
Magazines

Gloves

Silk and lace
Cotton
Kid, suede, and lamb
Cape
Mocha and doe
Lined and fur-trimmed
Woolen
Children's

Hosiery

Plain silk
Fancy silk
Cotton and lisle
Wool and cashmere
Silk and wool
Fancy sport
Children's and infants'

Men's Furnishings

Shirts
- Cotton
- Flannel
- Dress

Pajamas
Bathrobes
Mufflers
Handkerchiefs
Suspenders
Jewelry
Gloves
Collars
Bathing suits
Sweaters
Neckwear

Waists and Blouses

Cotton waists
Silk waists
Net cotton and silk
Wool waists

Merino Underwear

Silk
Wool
Wool and cotton
Wool and silk
Cotton
Children's

Women's Coats

Wool dress coats and capes
Evening wraps and capes
Sport coats
Silk coats, wraps and capes
Raincoats, capes, and dusters

Women's Suits

Wool dress suits
Silk and velvet suits
Sport suits
Riding habits

principle of merchandise control used by chain systems is most economical, and gives the necessary information to show what proportion of the business is done in particular lines.

How the plan operates.—After the classifications have been determined, the physical inventory should be taken and the stock classified according to the plan laid down. Thereafter, the buyers or assistants should classify merchandise listed on the invoices as purchases are made, on the return slips for merchandise returned to manufacturers, on mark-up and mark-down sheets, on merchandise transfers, and on the final inventory sheets. The ordinary practice is to give a number to each subdivision. For instance, in the classification given above, wool dresses would be identified by one (1) and silk dresses by two (2). When purchases are made the items on the invoice are identified by these numbers. Likewise, the subsequent increases and decreases in the inventory are kept by subdivisions. The sales by classification are derived from these figures, by subtracting the sum of the final inventory and net reduction, through mark-downs and transfers out of the department, from the opening inventory plus net purchases and additions through transfer.

The essentials of the plan are: (1) daily information of the purchases to date at cost and at retail in each subdivision of a department, regardless of how many divisions have been made; (2) current record of all price changes by classification; (3) a record of stock on hand by classification at the beginning and end of the period at cost and at retail. The sources of this information will be inventory at the beginning of each period, the purchase order and debit memorandum of merchandise returned to manufacturer, department transfer slips, price change slips, and the inventory at the end of the period.

Control at cost.—Merchandise may be controlled by classification or subdivision of departments either at cost or retail. If the inventory of each classification is taken at retail only, it may be reduced to cost by applying the complement of the purchase mark-up of the department. To the inventory of each classification at the beginning of the period is added the purchases at cost, giving the total inventory handled. A space should be provided on each order in which to write the symbol of the classification to which the order applies. In order to make the plan more accurate, it is suggested that not more than one classification of merchandise be purchased on any one order. Total purchases are charged to each classification

from the order. When merchandise is returned to the manufacturer, or when orders are canceled, the classification record is credited for the amount. Additions or subtractions are also made for transfers in or out of the classification. With this information available at all times the buyer has a guide to assist him in making decisions regarding the advisability of future buying.

Merchandise Plan—Spring Season 1923
DRESS GOODS DEPARTMENT No. 27

Dissection	Purchases Last Year		Cost Sales Last Year		Inv't'y—First This Season		Plan'd—Purchase This Season		%—To Total
A					1438	00	500	00	
B					5562	00	4300	00	
C					3566	00	4418	00	
D					859	00	300	00	
E					745	00	1000	00	
Totals	10017	00			12170	00	10518	00	

Fig. 27—Merchandise Plan by Dissections.

At the end of the period, inventory is taken, classified according to stock divisions, and reduced to cost on the basis of the purchase mark-up per cent of the department. The total of the inventory on hand at the beginning of the period, plus net purchases, minus the inventory on hand at the end, represents merchandise cost of sales for the period in that particular classification. With these data a merchandise plan and a purchase control can be set up for subdivision of departments.

As an illustration [1] of the method of operating this type of merchandise control, 5 subdivisions are made of the dress-goods department, shown in Figure 27: A, Black dress goods; B, Plain colors; C, Novelty dress goods; D, Silk and wool poplin; E, Cream-colored dress goods. Through an analysis of the inventory and its subsequent reduction at cost, the distribution of total purchase allotment of $10,518 was made to the different classifications, as shown in Figure 27. This is an

Dissection Record Spring Season 1923
DEPARTMENT 27 DISSECTION B

	Date	Orders		Returns To Manufacturer		Order Cancellation		Trans. In (Black) Trans. Out (Red)		Net Purchases		Total Purchase Inc. Inventory	
Invty.	2-1-23	$		$		$		$		$		$5552	00
	2-3	80	00							80	00	5642	00
	2-10	360	00									6092	00
	2-20			110	00							5892	00
	3-1					45	00			235	00	5847	00
										265	00		
	3-10	29	00							29	00	5876	00
	3-18	830	00							830	00	6706	00
										1144	00		
	3-25	115	00							115	00	6821	00
	3-27					20	00						
	3-29	762	00							742	00	7563	00
	3-30	1180	00							1180	00	8743	00
		3356	00	110	00	65	00			3181	00		
	April in Total	583	00							553	00	9320	00
										3764	00		
	May in Total	418	00	29	00	25	00			364	00	9690	00
										4128	00		
	June in Total	620	00			76	00	80	00	464	00	10154	00
										4592	00		
	July in Total	325	00	53	00	82	00					10344	00
		5302	00	192	00	248	00	80	00	4782	00		
	Inv on Hand											5083	00
	Sales at Cost											5261	00

Fig. 28—Merchandise Record by Dissections.

arbitrary division, decided upon in conference between merchandise manager and buyer.

The form shown in Figure 28 is the suggested one to be used for recording purchases as the orders are placed. The opening entry is of the inventory on hand in dissection [2] B, February 1, 1923, and is made in the last column only. Entries of orders and other records affecting the plan may be made, either summarized for the day, or in complete detail, as desired. The formula for the use of the form is: (1) Orders minus returns to manufacturers, minus order cancellations,

[1] Controllers' Congress National Retail Dry Goods Association: "Report of Fifth Annual Convention."

[2] Dissection as here used means a subdivision of merchandise in a department.

plus or minus transfers, as the net total indicates, equals net purchases. (2) Net purchases plus opening inventory, minus inventory on hand at the end of the period (which is to be posted in red in the last column of the form), equals sales at cost for the period. The net purchases to date as compiled in Figure 28 are then transferred to the open-to-buy report, Figure 29. This report is prepared as frequently as the merchandise manager thinks necessary. However, the time between reports is usually not longer than a month. Column 1, in Figure 29, shows the original planned purchases copied from Figure 27; column 2 shows variations to date from the original plan; column 3, the corrected planned purchases for the entire season; column 4, net purchases to date, taken from Figure 28; and column 5, the net open-to-buy for the balance of the season.

Dissection Open to Buy Report Spring Season 1923
DRESS GOODS DEPARTMENT No. 27

Dissection	Original Planned Purch.		Variations From Plan		Corrected Planned-Purch.		Purchases		Open To Buy	
A	500	00			500	00	325	00	175	00
B	4300	00	318	00	4618	00	3181	00	1437	00
C	4418	00	116	00	4534	00	3639	00	895	00
D	300	00			300	00	179	00	121	00
E	1000	00			1000	00	829	00	171	00
Totals	10518	00	434	00	10952	00	8153	00	2799	00

Fig. 29—Open-to-buy Report.

All figures in the dissection-purchase records and the dissection open-to-buy reports, Figures 28 and 29, are on a total season-to-date basis. Variations from the original planned purchases are made month by month, as actual operations develop. But they are computed on a total season basis. For example: Column 2, in Figure 29, shows a variation of $434, which increases planned purchases for the entire season accordingly. This form also shows that dissection B has been given $318 and dissection C $116 for the increased purchase allotment. This division was necessarily an arbitrary one,

Dissection Summary Spring 1923
DRESS GOODS DEPARTMENT No. 27

Dissection	Inventory At Beginning		% To Total	Net Purchases		% To Total	Total Purchases Plus Inventory		Inventory At End		% To Total	Cost Sales		% To Total
A	$1438	00	11 8	$ 681	00	5.7	$ 2119	00	$ 841	00	7.7	$1278	00	9.8
B	5562	00	45 7	4782	00	40 3	10344	00	5083	00	46.2	5261	00	40.4
C	3566	00	29.3	4829	00	40.7	8395	00	3411	00	31.0	4984	00	38.2
D	859	00	7.1	298	00	2.5	1157	00	738	00	6.7	419	00	3.2
E	745	00	6.1	1281	00	10.8	2026	00	927	00	8.4	1099	00	8.4
Totals	12170	00	100%	11871	00	100%	24041	00	11000	00	100%	13041	00	100%

Fig. 30—Merchandise Summary by Dissections.

based on the best judgment of the buyer and merchandise manager in conference.

Figure 30 is the summarization of the entire department of the figures as compiled in Figure 28. It is made up at the close of each season. Column 1 shows inventory on hand at the beginning and the per cent of each class of stock to the total stock carried; column 2, the net purchases of each class and the per cent of each to total net purchases; column 4 gives the same information with regard to inventory at the end of the period. The information compiled on the form shown in Figure 30 is the basis for future season comparison and planning. The particular advantage of a plan of this kind is that,

should a department be overbought, it is possible to localize the conditions. By taking an inventory one may determine the particular class of merchandise that is moving.

Control at retail.—Although the analysis of cost of sales by subdivisions indicates the lines which are moving, it does not show in what classification there is profit. For this reason some stores keep a record at retail by classification. The method of operating a plan of this kind is similar to the cost method, with the exception that the purchase record is taken from the invoice at cost and retail, instead of at cost only. In this way a percentage of purchase mark-up is established for each classification. Under the cost system, the mark-up of the department is used to reduce the retail inventory of each

Department______ CLASSIFICATION REPORT From______ to______ 192___

No.	CLASSIFICATION	Beginning Inventory Retail	Ending Inventory Retail	Purchases at Retail	Purchases at Cost	% Mark-Up	Net Sales Retail	Reductions	% Reductions	Gross Profit	% Gross Profit	Turnover	

Fig. 31—Classification Report.

classification to cost. Inasmuch as the mark-ups vary widely in some departments, the average mark-up for the department as a whole gives an inaccurate cost for the different lines. In addition to recording beginning and closing inventory at retail, an accurate record of price changes and other additions or subtractions from stock are kept so that an accurate net-sales figure for each classification may be derived. By applying the complement of the purchase mark-up of each classification, the purchases at cost are derived which, subtracted from sales, give gross margin. The form shown in Figure 31 is an example of a classification report which is used by an association of stores to arrive at the gross margin for each subdivision.

The classifications used in this report comprise only the major merchandise divisions of the department. It is felt by the stores using this form that the smallest department may advantageously use the major classification and, for the larger

departments, where more detailed divisions are necessary, further subdivisions may be made. It is necessary, in making out this report, to take a physical inventory at retail by classifications at the beginning and at the close of the period which is entered in the second and third column of the form shown in Figure 31. Beginning inventory plus purchases at retail, minus ending inventory at retail, gives net sales at retail and reductions. Inasmuch as a record of the reduction through mark-downs is kept, the net sales for each classification may be found. The number of times that this report should be made out depends entirely upon the nature of merchandise handled in the department. In some lines of merchandise a report is made only at the close of each six-months season. If at any time within the season the total departmental stocks are high in proportion to sales, or if the buyer is in an overbought condition, a physical inventory by classification will show in what lines the stocks are heavy. On the basis of the classification report the purchases by subdivisions of departments are planned for future operations. In some departments the report is made out every month, then the planned purchases appropriation can be distributed to the different months of the season as shown in Table 23.

Piece control.—The third and last step in a merchandise control system is a control by pieces. A merchandise plan by departments may show that a buyer should purchase $10,000 in hosiery in order to keep his stocks in the planned ratio to sales and, from the record of last season's sales, the plan by subdivision may indicate that; of this $10,000, $3,000 should be spent for plain silk, and the rest distributed among the other classifications. Such a plan, while effective to a certain extent, shows only the amount of money that should be invested in a particular line of hosiery, but does not show what priced hosiery should be purchased, nor what percentage in the different colors and sizes. The open-to-buy or purchase control in dollars is very necessary to show how much should be spent for the department, or subdivisions of the department, but it does not indicate what item of merchandise should be purchased. It is necessary in some departments, therefore, to maintain a perpetual piece control by keeping a current record of inventory, purchases and sales by physical units as well as in total amounts.

TABLE 23

PLANNED PURCHASES BY CLASSIFICATIONS FOR THE SPRING SEASON, 1924

Department—Gloves

Planned Stock, Dec. 31, 1923—$45,000.
Planned Stock, June 30, 1924—$40,000.

Classifications	Cost of Sales 1923	Planned Purchases 1924	Distribution of Appropriation to Months					
			Jan.	Feb.	Mar.	Apr.	May	June
1. Silks	$15,200	$16,360	0	0	$ 5,730	$ 5,730	$2,450	$2,450
2. Cotton	18,900	19,460	$ 5,640	$3,890	5,640	3,890	200	200
3. Kid, suede, and lamb	21,600	17,530	7,890	3,860	4,380	880	350	170
4. Cape	600	580	400	60	60	60	0	0
5. Mocha, mochan, and doe	400	390	270	40	40	40	0	0
6. Lined and fur-trimmed	200	0	0	0	0	0	0	0
7. Novelties	5,100	2,920	0	0	1,750	1,170	0	0
8. Children's	1,400	1,160	820	120	110	110	0	0
	$63,400	$58,400	$15,020	$7,970	$17,710	$11,880	$3,000	$2,820

Although the methods used by various stores differ in detail, the principle of a piece control is essentially the same throughout. The first step is to determine what information is necessary properly to identify the different items of merchandise, and which of these items are of major importance. A complete piece control in ready-to-wear requires a record of all items by classification, price, style, color, size, and, in some cases, by manufacturer's number. A common routine in keeping a piece control for ready-to-wear is indicated by the following system which is used by a large department store in New York.

The original records are prepared in the receiving department by the clerk who first receives the copy of the vendor's order. When the merchandise arrives this same clerk checks the invoice against the order book. This order book is arranged by manufacturers' numbers, and tells at any given time the amount of goods on order from any manufacturer—style, number, sizes, colors, and price. It also shows exactly how much has been received at any given time. A copy of the receiving ticket is forwarded to an inventory clerk in the ready-to-wear sections who has a ledger very similar to the one carried in the receiving department. This is a double check, and enables the store to prove the accuracy of the work. In addition, the clerk in the ready-to-wear sections receives daily the stubs from the merchandise tags representing sales made. These stubs are tallied into this ledger, as well as the mark-downs taken. (Space is provided to show first, second, and third reductions taken on each style number.) This ledger will then show what goods are on order, what have been received, and what lines have been selling, as well as what lines have required mark-downs and the number of mark-downs required before the garment was sold. A current record is also kept of all additions to stock through returns by customers, and deductions by returns to manufacturer.

This system shows at all times what is selling and what is in stock by items, which gives the buyer the necessary statistical information to maintain complete assortments of stock. The routine in the glove and hosiery departments usually consists in placing a tag giving the necessary information, such as size, color, lot number, and price on each item. At the time of sale this tag is removed from the merchandise and forwarded

to the merchandise-control section, where the deductions from stock are made.

It is the policy in some stores to allocate to different salespeople the responsibility of keeping complete stocks. For example, in one store the stock in the hosiery department is divided first as to kind—that is, silk, including plain and fancy; lisle and wool, including plain and sport; and children's. It is next divided as to price, and a clerk is put in charge of each one of these price divisions. The entire stock in numbers, colors, and sizes is taken by the fifteenth of each month, on a printed stock form. This stock form is sent to the reserve stock room, where the stock boy fills in the number of pairs of each size in reserve. It then goes to the buyer, who fills in the number of pairs he wishes to order for the following month's business. From this stock form, it is very easy for the assistant buyer to place the orders and to keep the stocks complete. Twice each week the clerks go to the reserve stock room to see what stocks in their section are low; to pick out what stocks they want sent down to the department; and to see if there is any new merchandise in. If any stock is low the clerk immediately fills in a form for re-order. After the reserve is filled in by the stock boy, the form goes to the buyer so that he can decide whether to re-order. The stock form is an absolutely accurate record for the buyer to follow in reordering. It is also a check on each clerk to make sure the forward stock has a sufficient quantity of whatever is in reserve stock. Whenever new merchandise comes in, a box is taken downstairs and shown to the whole department. In addition, each head of stock is notified by the assistant buyer of the quantity of new merchandise as it comes in. This system clearly defines the responsibility for keeping a complete stock.

A typical inventory sheet (Fig. 32), taken from the men's suit department, illustrates the operation of a simple perpetual inventory system.

In the upper left-hand corner the number of the suit and the retail price is indicated. The top of the sheet likewise shows the name of the seller and a description of the article. Of the $65 suits referred to in the present instance, nine were on order on the second of the month, five were received on the fifth, and two were sold on the sixth. This left three on hand on the seventh. On the ninth, four more were ordered and

one was sold, leaving two on hand. On the eleventh, three were received and one sold, leaving four on hand. On the fourteenth, one of the suits was returned to the seller, bringing the amount on hand down to three. Whenever anything is returned to the seller, the amount is shown in red ink in the receiving column. If a customer returns a purchase and gets his money back, the credit is indicated in red ink under the "sold" column. In case of a mark-down, a line is drawn through the price at the upper left-hand corner, and the new

#186 $65.00			SELLERS Wolf & Co.										Golf Suit (3 piece)										Tweed										
STYLE			RESOURCE										DESCRIPTION										MATERIAL										
Cost	Size	May	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
$46.50		Rcd					5						3			1			6						4							4	
		O.H.							3			2		4				3		7			1			4			2	1			3
		Sold						2			1		1					2			2	4			1			2	1			2	
		O. O.		9							4				7										5		10						
June		Recd	2		6					3																							
		O.H.		5		2			3		4		3																				
		Sold.			4			1		2		1																					
		O. O.											3																				
		Rcd																															
		O. H.																															
		Sold																															
		O. O.																															
		Rcd																															
		O. H.																															
		Sold																															
		O. O.																															
		Rcd																															
		O. H.																															
		Sold																															
		O. O.																															

Fig. 32—Perpetual Inventory Record Sheet.

price is substituted. A cross is made in the "on hand" column at the date when the mark-down went into effect.

The function of maintaining a perpetual piece control may be performed by the buyer, merchandise manager, or controller. Inasmuch as piece records are maintained chiefly to aid the buyer, most stores make the buyer responsible for the operation of the system. But, as a general rule, the piece records must be checked periodically by the merchandise or controller's office to insure accuracy. In one large store in New York, the entire function of piece control is performed under the supervision of the controller's office. The management of this store feels that the keeping of records belongs to the

controller rather than to the buyer; and furthermore, that, inasmuch as the general principles of perpetual piece control are essentially the same in all departments, a centralized control over all systems will result in the development of more efficient methods than if left to the control of individual buyers or merchandise managers. The success of a system of perpetual piece control depends largely upon the amount of clerical details which the buyer and merchandise manager are obliged to study daily. A brief summary of the details which it is essential to act upon is all that need be given.

Planning a model stock.—A complete or model stock at any particular time is an assortment of merchandise which is in direct proportion to sales, as to price, size, color, and style. The planned stock at the beginning of any particular period should consist of just those items which the buyer expects to sell during that period, or until those items may be replaced. In most lines of merchandise it is impossible to anticipate just what quantity or type will be sold, but by a study of sales over a corresponding period of years and of present tendencies, buyers should be able to forecast, within certain limits, the nature and quantity of sales. It may readily be seen that a complete stock need not necessarily be a large stock. An analysis of most stocks which are extremely high in proportion to sales will disclose the fact that a large part of the investment is in merchandise which did not move during the former period and could not be expected to move during the planned period.

In constructing a buying plan for a complete stock it is necessary to consider past records and present tendencies in a department (1) by stock divisions, that there may be a properly balanced stock; (2) by color division of each, in so far as they approximate stability or can be anticipated by current tendencies; (3) by style subdivision of each; and (4) by price lines in accordance with previous records and present tendencies. Divisions or classifications will vary with different stores and different departments. An overstock in one color which does not move is just as serious as an overstock in a slow-moving classification or price line. In the example given on page 231, 88 per cent of the total business for the previous season was done on 7 price lines, although the department had 34 different prices.

The method of planning by items is well illustrated by the

Planned st. first of each month	Feb.			March			April			May			June			July		
		$5,000			$8,000			$5,500			$5,000			$4,000			$3,000	
Prices	Per cent	$	Pcs.	Per cent	$	Pcs.	Per cent	$	Pcs.	Per cent	$	Pcs.	Per cent	$	Pcs.	Per cent	$	Pcs.
$ 5.00																12	$ 300	72
7.50																7	210	28
10.00										31	$1,550	155	37	$1,480	148	37	1,110	111
12.50	6	$ 300	24	5	$ 400	32	6	$ 330	26	8	$ 400	32	16	640	51	8	240	20
15.00	15	750	50	17	1,360								28	1,120	75	30	900	60
18.50	13	650	35	13	1,040	56	13	715	39	16	800	43	8	320	17	2	60	3
20.00	16	800	40	13	1,040	52	15	825	41	13	650	32	6	240	12	4	120	6
22.50	11	550	24	11	880	39	15	825	37	5	250	11	2	80	4			
25.00	19	950	38	14	1,120	45	22	1,210	48	19	950	38	3	120	5			
30.00	8	400	13	12	960	32	8	440	15	8	400	13						
35.00	6	300	9	9	720	20	4	220	6									
45.00	3	150	3	3	240	6	2	110	3									
55.00	3	150	3	3	240	4	1	55	1									

following plan which is used in the millinery department of a specialty store:

Planning the Complete Stock.

1. Selection of best selling prices is based on spring season of 1921, which was merchandised on 34 prices. Investigation of 1921 sales analysis showed that 7 prices were responsible for 88 per cent of the total business. This and other sales information led the buyer to decide upon the following standardized price lines for the department.

Prices	*Per Cent of 1921 Business*	*Determined Per Cent for Mdse. Purposes*
$12.50	..	6
15.00	15	15
18.50	13	13
20.00	16	16
22.50	11	11
25.00	19	19
30.00	8	8
35.00	6	6
45.00	..	3
55.00	..	3
	88	100

In the spring season, 1922, the seven prices $15 to $35 accounted for 92 per cent of the total business done; this convinced the buyer that these prices should be merchandised so that he would have complete stocks retailing at these standardized prices.

2. Distribution of planned stock figure, first of each month, to best selling prices is next made as shown on page 230.

The general principle and procedure in making a complete merchandise plan may be summarized by a brief description of the plan used by a department store which does an annual business of approximately $30,000,000. This plan involves the use of three forms called the model stock plan, model stock analysis, and the open-to-buy analysis. On the first of these forms there are recorded for each month the figures indicated in Figure 33. These are taken from the six-months plan and represent the planned operation of the department as a whole. The planned stock is next subdivided and entered by classification, under "summary by stock division," on the lower half of the form. This is the first step in breaking up

Buyer ______________

O.K. Div. Mgr. _____ for (period) October Dept. 89-B Date 9-10

Approved ___________

SUMMARY

Instructions:

1. Model Stock plans must be submitted in duplicate to the merchandise office before placing orders for period covered by such plans.

   A "MODEL STOCK ANALYSIS" by stock divisions and prices must accompany this summary.

Enter the following figures from Six-Months Plan

Planned stock end of period	$20,000
Planned sales	15,000
Planned mark-downs	1,000
Mark-up (six-months plan)	32%
Mark-up (to take care of charges of mdse.)	7%
Total mark-up required	39%

If conditions arising since making out six months plans will, in your judgment, make it advisable to change any of the above planned figures, indicate beside plans the new figures recommended and take up with the merchandise office at once.

SUMMARY BY STOCK DIVISIONS

OF TOTAL STOCK TO BE ON HAND AT END OF PERIOD

Stock Classification		*Total Retail*
Wool dress suits		$10,000
Silk and velvet		1,000
Sport		3,000
Riding habit		2,000
Leeway		4,000
	Total	20,000

Fig. 33—Model Stock Plan.

the planned stock into smaller units for the purpose of analysis. The item marked "leeway" is provided to take care of special purchases of stock brought about by changes in demand which cannot be predetermined.

The model stock analysis (Fig. 34) provides columns for a detailed analysis of the subclassification by price lines, showing the number of prices sold during the corresponding period of the previous year, sales this month and to date, and the planned stock at the end of the following month. It is customary to make out this form the tenth of the month preceding that for which the plan is made. For example, the stock for November would be planned during the first half of

MODEL STOCK ANALYSIS Dept. 69 Date 10 Sept.

Period October, 1921

Sub. Div	Prices	F. L. Prices	Last Mo. Sales		This Mo. Sales			Next Mo. Sales			Planned Stock End of Next Month		No. Styles	Sales Last Year Following Month
			Last Year	This Year	Last Year	Est. This Year		Last Year	Est. This Year					
			Pcs	Pcs	Pcs	Pcs	Total Retail	Pcs	Pcs	Total Retail	Pcs	Total Retail		Pieces
Cloth Suits	25.00		25	60	5	15	375.00	75	150	3750.00	50	1250.00	10	65
	35.00	L												
	45.00	B												
	55.00	H	etc.											
	65.00													
Jersey Suits	etc.													
TOTAL														
AVERAGE														

Fig. 34—Model for Analysis of Stock.

October. If the plans were being made for 1924, the experiences of July and August of 1924 would be compared with those of the corresponding months of 1923 and the planned figures based upon the relative conditions to date. The stock for November 1 would already have been planned the previous month, so that the plan made in October should include the amount of stock which should be on hand December 1, to take care of the December business.

The third form (Fig. 35), which is used by this store, is the open-to-buy analysis. This form is used in arriving at the amount which the department is open-to-buy in individual items. It is based upon the two preceding forms and is filled out before purchases are made. According to the information shown on the open-to-buy form above, there are 60 cloth

suits at $25 in stock and 40 on order, making a total of 100 suits which will be available for sale during October. The planned sales for the department are 150 suits and the planned stock at the end of the period 50, making a total of 200 suits which must be provided according to the plan. The department is thus open-to-buy 100 suits.

This plan illustrates the preliminary planning and analysis that precede the determination of the amounts to be purchased in departments and subdivisions of departments, and

OPEN-TO-BUY ANALYSIS Dept. 69 Date 1 Oct.1921

Period ending October 31, 1921.

Stock Div and Price	Stock on Hand	Stock on Order	Total	Last yr. sales from today to end of period	This yr. est. sales—today to end of per'd	Stock end of period if no more purchases are made	Pl'n'd stock end of period (model st'k)	O.T.B.	Plan to buy now
	Pcs	Pcs.	Pcs	Pcs.	Pcs.	Pcs.	Pcs.	Pcs.	Pcs.
Cloth Suits (25.00)	60	40	100	75	150	-50	50	100	40

Fig. 35—Open-to-buy Analysis.

the number of pieces in the different subdivisions. At best this type of planning can only reflect the buyer's best judgment as to what he expects to do, first in a general form for a six-months period, and then more in detail from month to month. The bases for these plans and adjustments are: (1) a record showing what was sold in each class of merchandise in the corresponding period of the previous season; (2) a current record showing what is selling as taken from the daily sales audit; (3) information of what customers are asking for that is not in stock; and (4) what competitors, other stores, and manufacturers are showing in other cities and abroad.

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Problems.

1. The Marsh department store has an annual sales volume of $6,000,000, of which $200,000 is in women's hosiery. An analysis of the sales for 1923 showed that 72 per cent of the sales in hosiery were made in three price lines, although 11 price lines were carried. The store carried two nationally advertised brands of hosiery and one unbranded line. An analysis showed that the rates of stock turn on the branded lines were 10 and 6 respectively, while the stock of unbranded hosiery was turned only 2 times. An analysis of stock showed that the lines were more complete as to color and size in the branded hosiery than the unbranded, although the ratio of stock to sales was very much greater in the unbranded hosiery. At the present time there is no stock-control system in operation in the hosiery department, but the merchandise manager has instructed the buyer to draw up a plan whereby he may have currently the sales and stocks by brands, prices, classification, and color.

Draw up a complete stock-control system for this department, assuming that there is an average of five major colors in each of the classifications shown on page 217.

2. The Canton specialty store uses the following size scale in buying women's and misses' coats, suits and dresses:

BASED ON QUANTITY OF 100 GARMENTS

Size	14,	16,	18,	20,	34,	36,	38,	40,	42,	44,	46,	48.
Quantity ...	9,	22,	19,	—,	5,	9,	10,	10,	8,	5,	2,	1.

The buyer in this store recently had an opportunity to buy a lot of 1400 suits at an average price of $29.50, which was 10 per cent below normal for this quality of merchandise. This concession was made chiefly because the suits were particularly heavy in end sizes. The following shows the approximate range of sizes in this lot:

Size	14,	16,	18,	20,	34,	36,	38,	40,	42,	44,	46,	48.
Quantity ...	168,	252,	224,	—,	126,	196,	98,	112,	42,	84,	56,	42.

The buyer felt that he would be able to move the entire lot by an average mark-down of 20 per cent on the suits which remained after the normal demand had been taken care of.

(*a*) Assuming that 1400 customers visited the department, that these customers conformed to the size scale of the store, and that each customer that could be fitted from this special lot of 1400 suits purchased, how many suits remained and how many customers of the 1400 could not be fitted?

(*b*) Should the suits have been purchased?

3. The Marcy department store has a yearly sales volume of approximately $18,000,000. This store has recently installed a perpetual piece control in several of its ready-to-wear departments. Under the new system, stock-keeping in misses' dresses begins when the merchandise is received in the department. It is carefully counted and signed for. It is then put into stock according to:

1. Classification.
2. Price.
3. Style.
4. Color.
5. Size.

Each salesperson in the department, with the exception of the sponsor, is responsible for a certain amount of stock. It is her duty, each morning, to go over the dresses; to arrange them in the manner as indicated above; to have them repaired if any of the merchandise is in bad condition; to see that they are hung upon proper hangers; to see that they all have the necessary hooks, eyes, buttons, etc.; and to see that they are ticketed correctly. No regular inspection is made of the girl's work, but the buyer is likely at any time to go through the stock.

Once a week the stock is taken according to season letter and price. Afterwards, a summary is made of this according to season letter only. It is an effective way of seeing how the stock is moving. Once a month stock is taken in the same way for the merchandise office and at the end of each season stock is taken and checked by people outside the department. For the buyer's reference a book of sales is kept. Each day the goods which have been sold are marked down in this book according to classification and price. This is of use in showing what type of merchandise is the best seller and what is the best selling price.

A more detailed record of the merchandise is kept on the tenth floor in the marking room. Here entries are made in a ledger according to classification, price, style number, manufacturer's number, color, and size. The date when the merchandise is received is entered. Each day the stubs of the previous day are sent up and checked off. When a credit comes, it also is drawn in the ledger. This gives exact and

concise information of each number received in stock. At a glance one can tell how many dresses were received and on what day, how many have sold, how many credits and how many are still in stock. This ledger is of the utmost importance in re-ordering.

(*a*) Draw up a chart showing the flow of records and the points at which a cross check is made of inventory in the above department.

(*b*) Could any of the records used in this department be eliminated without destroying the possibility of an accurate perpetual piece control?

CHAPTER X

THE SALES FORCE

Instead of waiting passively for patronage, a merchant who seeks to make the most of his opportunities adopts aggressive sales methods. The two chief means of promoting sales are by personal salesmanship and advertising. In the small store the proprietor may actively participate in the selling of merchandise to customers and may personally employ, train, and supervise the salespeople who assist him. In such instances the problems of sales organization are comparatively simple. In the larger store, however, the proprietor or owner seldom comes in contact with the customers, and the salespeople, therefore, become the personal representatives of the firm by which they are employed. The problem of sales promotion in these stores includes, in addition to formulating the major merchandising policies, the selection, training, and supervision of salespeople and the adoption of an effective method of pay.

Selection of salespeople.—The policies of the store determine largely the type of salespeople to employ. When the major sales appeal is low price, the task of selling is to offer the product to as large a number of potential customers as possible. At the other end of the scale, where the store aims to make an appeal to an exclusive clientele, the selection of salespeople must be made on the basis of appearance and ability to give service in conformance with the general atmosphere of the store. Some of the larger institutions have attempted to make an analysis of the qualifications necessary for different positions in the store and to provide a definite set of specifications which the employment manager may use in the selection of employees. These qualifications fall under the three major headings: personal appearance, health, and general intelligence. The first of these is of especial importance in salespeople, since they come in direct contact with customers. The personal appearance of an applicant, as manifested

in his cleanliness and his dress, affords an indication of a quality that is desirable for successful salesmanship, especially in stores catering to the higher class of trade. The impression which a salesperson will create on customers may be predetermined with a reasonable degree of accuracy by an interview with the employment manager or executive under which the employee is to work.

The general status of the employee's health may be ascertained by an interview, from the questions asked on the application blank, and by a physical examination at the time of employment. From the point of view of the store, the health of the worker is important as a factor in determining his efficiency. The work in a selling department requires physical stamina in the salespeople, not only to perform the actual routine of the department, but to maintain the morale of the selling organization. This is particularly true as to absenteeism, and the consequent loss in production. Some of the larger stores have developed elaborate facilities for the care of the health of employees, giving particular attention to working conditions, periodic physical examination, first aid, home visiting, hygiene lectures, and general preventive work in medicine.

The third factor in the selection of employees is that of mental fitness to fill a position. Effective salesmanship in some lines of merchandise requires technical knowledge, as in the sales of electric motors and radios. In other lines, such as higher-priced furniture and draperies, a knowledge of the principles of interior decoration is essential. The qualifications for selling this type of merchandise may be determined by a trade test, or by a survey of the past experiences of the employee as registered on the application blank. The major qualifications for a cashier are mental and physical alertness, accuracy, and honesty. The first two of these qualities may be determined by a simple test before the applicant is employed. Similarly, tests may be given for certain office positions, such as stenography, filing, and operating bookkeeping machines. The major qualifications for these positions are definite and may be measured with a reasonable degree of accuracy. The mental fitness of salespeople, however, cannot be so readily ascertained. As a foundation for salesmanship, a certain minimum grade of general intelligence is required, which may be determined by a pre-employment test

covering mathematical accuracy, and ability to read and to write legibly. At the other end of the scale, the general pre-employment test may be used to indicate the upper limit of intelligence above which labor turnover increases. By correlating the length of service with the grade received, it is possible to determine approximately the rating above which salespeople should not be employed, because of the possibility of a low average length of service. It is the aim of every institution to select employees who are fitted to become permanent members of the organization. The expense of employing and training salespeople necessarily adds to the cost of operation.

As indicated above, the appearance, health, and general or specific intelligence of salespeople may be ascertained with a reasonable degree of accuracy by interview and examination before employment, but the degree with which these characteristics will be used cannot be so readily measured. Tact and courtesy in dealing with customers are indispensable for successful salesmanship. One of the chief tasks of a salesperson is to leave each customer or prospective customer in a friendly attitude toward the store and thus increase the good-will of the organization. Another requirement for a salesperson is veracity—truthfulness. This is essential to build up the confidence of the store's clientele and thus to decrease sales resistance. Advertising managers throughout the country have generally recognized the loss in pulling power which has resulted from untruthful and exaggerated statements, and have taken decisive steps toward adopting a standard to conserve the reputation of advertising. A similar problem presents itself in the statements of salespeople, but these cannot be so readily supervised except by the selection of reliable employees. Reliability is a composite qualification that is judged by numerous contributing characteristics. One of these characteristics is loyalty; unless a salesperson is thoroughly loyal to the firm he represents, he cannot be counted on to meet difficult situations effectively. Another characteristic is the ability to take a true interest in whatever task is assigned. In order to be reliable, he also should be industrious and manifest persistence, a quality that is sometimes called "stick-to-it-iveness."

Another quality that a salesperson should possess is saga-

city, that is, the power to recognize circumstances of significance and the ability to exercise keen, practical judgment in solving the problems with which he is faced. The mere order-taker requires little of this quality. If, however, a salesperson is expected to render constructive merchandising service he must have the ability to meet objections and to turn seeming objections to practical advantage. Although the foregoing qualifications are essential for success in salesmanship, there has not yet been developed a systematic analysis by which these characteristics may be rated before the salesperson is employed. Consequently, it is necessary to develop some of these qualifications by training after the employee has been selected.

Training salespeople. The first step in training consists of instruction in the general policies of the organization as to its treatment of customers. They should thoroughly understand the particular appeal which the store is making, its policy regarding returned goods, and the extent to which it guarantees the qualities of its goods. The store history, dress regulation, system, service features, and general store rules are also included in the initial training. Familiarity with these subjects helps to increase the interest of salespeople in their work, to strengthen their loyalty to the firm, and to decrease the number of errors in performing the routine of selling.

The second step consists of instruction in location of stock and an explanation of specific value-giving qualities of special lines of merchandise—the selling points that have been decided upon as being the most significant and influential.

The third step consists of an analysis and explanation of the buying motives which influence the purchases of the prospective customer. Specific rules that will satisfactorily inform a salesperson how to handle each of the varied situations in which he finds himself cannot be formulated. He may be given instruction, however, in the general principles of selling. The initiative in sales transaction usually lies with the seller and consists of emphasis upon one of the buying motives which experience has shown makes the most effective appeal. The number of buying motives that are operative among consumers is not large, and by observation and test it is possible to ascertain which are influential in selling any product.

The buying motives which induce customers to purchase

may be divided into two major classifications: (1) primary motive, and (2) selective motive. The former, or primary motive, is that which gives the customer the initial impulse to purchase a certain class of merchandise offered for sale. The latter, or selective motive, is that which causes the customer to choose between two articles serving the same purpose. For example, the initial impulse that causes the customer to purchase a golf set is the pleasure of recreation. This is a primary motive. On the other hand, the impulse that causes the customer to purchase a golf set at one store rather than at another, or one brand in preference to another, is economy, or desire for quality. This is a selective motive. These buying motives must be clearly differentiated if the salesperson is to do effective selling.

Buying motives may also be classified as emotional, which represent impulsive prompting to action and have their origin in human instincts and emotions, and rational, which are those aroused by an appeal to reason. Purchases are stimulated through the emotional buying motives by arousing the desires of customers to satisfy their instincts and emotions. These motives include pride of personal appearance, distinctiveness, emulation, cleanliness, and similar motives. When influenced by rational buying motives the customer carefully weighs the advantages and disadvantages of the purchase before acting. This group includes such motives as economy in purchase or use, durability, and efficiency in operation. The emotional buying motives are aroused by suggestion, comparison, description, or association of ideas; but in making an appeal to the rational buying motives it is essential to present a careful statement of the reasons why the customer should buy the article. For example, in selling a dress the salesperson should know whether the customer is influenced by the motive of distinctiveness, that is, the desire to display leadership in personal appearance, or by the motive of emulation, which is the desire to buy what is in style or fashion. It must be recognized that these motives are essentially opposite, and a statement that the customer should buy a dress "because it is being worn" will deter the purchase on the part of a customer who desires distinctiveness. The salesperson should first ascertain which motive or motives probably will influence the purchase of a prospective customer, and then

concentrate his selling efforts on the stimulation of such motives. As soon as a salesperson has discovered which motives are likely to influence a customer, he may very materially strengthen his selling attack. Customers are interested only in those qualities of an article which they recognize as pertaining to their past experience. The value-giving qualities of merchandise are those which give indication to the customer of overcoming their unpleasant experiences. For example, in the purchase of a necktie the customer is interested in such statements as "will not fade or wrinkle," and "will wear well," because they tend to solve his difficulties and give promise of more pleasant feelings.

In the training of the salesperson the experiences which an average customer has had with particular articles may be listed and the qualities of the article which will overcome these difficulties pointed out. These are the value-giving qualities of merchandise which stimulate the impulse to purchase. The common objections which the average customer will make may also be listed and the salesperson instructed how to overcome them. The course of training should also include instruction on how to approach a customer, how to secure favorable attention and interest, how to convince a customer that she should buy, and, finally, how to close the sale. Since the initiative in sales transactions usually rests with the seller, the salesperson must be instructed in the method of closing the sale and of associating the purchase with other lines of merchandise by suggestive selling. The function of selling includes not only the satisfying of expressed wants on the part of the customer, but the arousing of latent desires for merchandise.

Training salespeople may be done by the buyer or by the educational department, depending upon the size of the store and the degree with which it is functionalized. The initial instruction in system, store rules, and regulations is more effectively done in classrooms under a separate training division. The general principles of salesmanship may also be given effectively by the educational department in lectures, and by demonstrations of correct methods of displaying merchandise and of meeting difficult situations in dealing with customers. The instruction of salespeople in the value-giving qualities of merchandise, however, cannot be done so readily

by the training division, except in the more staple lines. It is generally recognized that merchandise information should originate with the buyer, who may either instruct the salespeople or give the selling points to the training department who in turn will instruct those who sell.

It is possible in some types of merchandise to use manuals or pamphlets, containing in concise form its most important selling points. This information is usually compiled by the educational department in coöperation with the buyer and older salespeople, or by the buyer himself. The merchandise manual should contain the information which will aid the salesperson to make an effective selling appeal, such as the classification of material used and the particular selling points of each; the value of different types of workmanship, styles, and designs; the common objections which customers make in purchasing, and the answers to these objections. In some types of merchandise the materials, styles, and workmanship change so rapidly that a manual is impracticable. In these departments the buyer should instruct salespeople personally regarding the particular qualities of certain lines of merchandise, especially when new stock is received.

It is of especial importance that salespeople have a logical reason for differences in the price of similar lines. Inasmuch as the buyer selects the merchandise and places the different prices upon it, he is the person to explain to salespeople the reason for the price, or why he purchased certain items. There is a diversity of opinion as to the best method of imparting this information. If given through the educational department it must necessarily be delayed in reaching the salespeople. Furthermore, the values of particular lines cannot be pointed out as effectively in the classroom as on the selling floor. Therefore, the most successful plan of instruction is the most direct, that is, from buyer to salesperson, with the method of giving the instruction supervised by the educational department. By outlining systematically the talks of the buyer, the educational department may perform its function of training and at the same time give the buyer, who is, presumably, a specialist in his particular lines, an opportunity to instruct salespeople currently in the new merchandise.

Methods of Paying Salespeople.

Effective salesmanship depends to a large degree upon the state of mind of the salespeople as affected by the method of compensation. One of the most fundamental laws governing human behavior is that people naturally exert themselves along the lines which give them the greatest amount of remuneration. In the retail store this remuneration is measured in terms of wages, recognized opportunities for promotion, and the commendation or approval of those for whom the employee is working. The essentials of an effective method of payment are: (1) that it be fair; that is, that it offer to employees the highest compensation which they are capable of earning, consistent with the net return to the store; (2) it must not only be fair, but must easily be understood by the employee and recognized as fair; (3) it must be easy to adjust to changing conditions within the department or store.

The major problem, therefore, in determining an effective method of payment, is to bring about an advantageous ratio between production and wages; in other words, to decrease the percentage of salary and wage expense. The measure of real production of salespeople is the amount of ultimate net sales which are made because of their influence. Each of two salespeople in a department may have an average sale of the same amount, but one may be more productive than the other, because of the goodwill she creates in the minds of customers with whom she deals. The common practice in retail stores, however, is to compensate salespeople on the basis of tangible production, which is net sales.

Although there are a large number of systems of payment in effect in retail stores, they may be classified under three major headings: (1) straight salary; (2) straight commission; and (3) a combination of salary and commission. The combination of a straight salary and commission falls under the following heads: (1) straight salary supplemented by a commission on sales, or a bonus, or both; (2) profit-sharing plans, whereby the employee gets a certain per cent of the gross or net profits; and (3) efficiency plans based upon the point system.

Straight salary.—The straight salary is perhaps the oldest method of payment. Under this system wages are usually determined by the character of the employee, the local market rate for the particular position, and wage laws. The effectiveness of this type of payment depends (1) upon the proper selection of employees, and (2) upon the facility with which adjustments in pay are made in relation to the devolopment of the salesperson as measured by production. The advantage and disadvantage of a straight wage as against other methods of pay vary with the type of store and the nature of the work done. Some merchants feel that a straight wage system is well adapted to the lower grade retail store, where inexperienced persons are employed. For example, where the nature of the business requires a very low overhead expense, as in many general merchandise and variety stores, the wage at market rate is the cheapest method for the store. On the other hand, it has been found that the production of salespeople has been greatly increased in the lower type of stores by the introduction of a stimulus in the form of "added pay for increased production."

The straight wage is especially advantageous in the selling departments of stores in which service to customer is of major importance. For this reason, a great many stores catering to the higher class of trade have re-adopted the straight-salary method after experimenting with other payment systems. When a store changes from a commission to a straight salary, the usual practice is to make the total amount paid for the previous year under the commission plan the basis of payment of a straight wage. The monthly salary is arrived at by dividing this amount by twelve. If the salespeople are paid the same amount each month, the selling expense will be higher, of course, during the periods of low sales, unless the number of salespeople is adjusted to the volume of sales by discharging, transferring, or granting vacations during periods of low-sales volume. The discharge or transfer of salespeople creates a higher rate of labor turnover which results in increased expenses.

Under the straight wage the salespeople are more willing to take care of stock, to attend lectures for the improvement of service, and to perform other functions, such as marking merchandise during slack period and exchanging or making

adjustment in merchandise returned by customers. The common practice under the commission system is that a customer must find the salesperson who made the original sale in order to get an adjustment. When a customer returns merchandise without the sales check and cannot identify the sales clerk the store has difficulty in allocating the responsibility. Furthermore, ill will is created if the customer does not find salespeople willing to make adjustments.

Straight commission.—Under the commission plan, salespeople are paid a certain percentage of net sales. This plan provides remuneration in proportion to work done, thus giving a strong incentive to the employee to exert every effort for large-sales volume. In order to provide living wages during the period of low-sales volume, a weekly drawing account is given the salesperson, based usually on his previous record of sales. He is usually paid quarterly or semiannually the balance of his earnings. If the total commission for a certain period does not reach the total paid on the drawing account, there are two alternatives: the amount overpaid may be carried over to the next period and charged against future commission, or each period may be closed out and the drawing account lowered or the employee discharged or transferred.

Another advantage in the straight commission plan is that it provides an accurate forecast of selling costs for budgeting purposes. If the drawing account is properly adjusted and the percentage of commissions accurately determined for the year's business, the weekly and monthly remuneration of the salesperson is distributed over the year, so that he is always assured a living wage and his total yearly income depends upon his efforts. Most stores have found it advisable, even under a straight commission plan, to guarantee the employees a base salary, because of the seasonal variation in sales volume for the different departments and other causes over which the salesperson has no control.

The disadvantages of a straight commission plan lie first in the possibility of overselling the customer. Salespeople are more likely to urge that the customer take the merchandise, with the hope that it be kept, rather than to spend more time in trying to find the most suitable merchandise or to make an appeal to a logical buying motive. In most stores the commission is paid on net sales, so that a subtraction is made from

the total sales for returned merchandise, but the store suffers a dual loss—the cost of the sale and the return, and the possibility of a dissatisfied customer. If a straight commission on sales is paid there is more liability for the salesperson to place immediate sales above the long-time interest of the store. He is less willing to give his time to an explanation which does not seem to yield immediate sales. Other things being equal, he follows the lines of least resistance, selling the merchandise which it is easiest to sell, such as mark-down or sale merchandise and the lower-priced lines within the department. The result is a lower average sales check and less net profit to the store. There is a tendency also for salespeople to stay in a department only during the peak season and then go to another department or store in order to take advantage of peak seasons in other lines. This causes a high rate of labor turnover which adds to the selling costs. Again, if the drawing account has been overdrawn during the slack period, the salesperson may leave the department.

Salary and commission.—Recognizing the advantages and disadvantages accruing either to a straight wage or a straight commission, a great many stores have adopted a combination of the two systems. Although these plans vary widely, the major principles are brought out by the following plan which is used in a number of stores. The total remuneration is made up of three parts: (1) a base salary; (2) a small commission of from 1 to 5 per cent on all sales, or on sales up to the quota; and (3) a larger commission of from 1 to 8 per cent on all sales over the quota. The base salary is determined in about the same way as a straight salary, except that it may be lowered sufficiently to permit the bonus plan to come into operation. The direct-selling cost of the department is next determined. The usual practice is to divide the average of the total wage paid during a period by the average total sale for the same period. Thus, to get the selling costs for February, the average wages paid during this month for a period of from 1 to 5 years is divided by the average sales for February for the same number of years. By dividing the base salary by the selling cost percentage, a quota is established which each salesperson must reach in order to pay for his base salary.

The elimination of the buyers' and assistants' sales should

first be made in arriving at the true cost of selling within each individual department. If the bonus is to be paid on a monthly or a semi-annual basis, the sales and selling costs should be grouped accordingly. In some stores this selling cost percentage is decreased, because the principal aim of the bonus system is to reduce selling cost. It is difficult, however, to explain to employees the reason for decreasing the selling cost percentage, and for this reason it creates antagonism toward the method of pay. In some stores this quota is adjusted for a one-week or two-week period, whereas in others it is adjusted only quarterly or semi-annually. The length of time for which a quota should be adjusted depends directly upon the seasonal fluctuation in sales of the department. The most effective quota is that which a salesperson might reasonably be expected to make during the week or month.

A commission of from 1 to 8 per cent is paid on all sales above the quota. This commission is called a bonus to distinguish it from a percentage paid on sales in which no quota is established. In some stores a smaller commission is paid on sales up to the quota. The following data will indicate the application of this method of payment:

WEEKLY SALARY, $18.00, PAYABLE EVERY FOUR WEEKS.

Commission below quota, .5 per cent; commission above quota, 2 per cent.

Month	*Average Net Sales for Three Years*	*Average Total Salary (3 Years)*	*Cost of Selling*	*Monthly Quota*	*Actual Sales*	*Excess Sales*	*Commission*	*Bonus*	*Total Wage*
Jan.	$2,592	$226	8.7%	$ 825	$ 875	50	$4.13	$1.00	$77.13
Feb.	4,725	257	5.4	1,320	1,400	80	6.60	1.60	88.20
March	5,767	282	4.9	1,467	1,500	33	7.34	.66	80.00
April	7,480	416	5.6	1,280	1,350	70	6.40	1.40	79.80

Under the above plan, the salesperson is assured a base salary and one-half per cent commission on a sale, even though the quota is not reached. Inasmuch as the commission on sales above quota is larger, he is stimulated not only to reach the quota, but to sell as much as possible above the quota. In some stores a quota is set and a commission is paid only

above quota. There is a tendency under this plan for salespeople to become discouraged if, during the period, it becomes evident that the quota cannot be reached. In a great many cases, it has been found that they urge customers to delay purchases into the next period when they will have an opportunity to get a commission on the sales. In other words, they are attempting to increase the sales peaks rather than smooth them out. Thus, a quota that cannot be reached under this method, not only does not stimulate but actually retards sales. However, if a commission is paid on sales up to the quota, there is, first of all, an incentive to sell, whether the quota can be reached or not, and, if the commission above the quota is larger, there is an additional incentive to sell after they have reached the quota, because the commission, as in the above example, quadruples itself.

In some stores no commission is paid on sales below quota, but above quota a bonus rate is paid which is as high as the selling cost. The disadvantage of paying a high bonus rate is that the wages will fluctuate too widely, because of inability, even under the most normal circumstances, to determine an accurate quota. Another disadvantage in this plan is that there is no possible way in which a department or store can decrease its selling cost. If a salesperson does not reach her quota the selling cost is increased, whereas, if the quota is exceeded, the selling cost remains the same. Since the primary purpose of a bonus system is not only to increase sales but to decrease selling costs, the payment of a commission above quota equal to selling cost does not seem to be an effective means of decreasing the selling expense. The difference between commission above and commission below quota should be wide enough to give an added stimulus to reach the quota. It must be remembered, however, that the commission above quota must be kept considerably below the selling cost for the department, inasmuch as a commission has already been added to the sales below quota.

Another method used to adjust quotas is the following: A schedule is first worked out showing the percentage of the year's business which each department did in each month. The salesperson's yearly quota is next determined by dividing the yearly salary by the selling cost. Assuming that 6 per cent of the total year's business of the department was done in

January, the salesperson's quota would be 6 per cent of her year's quota. Although different in the method of arriving at the quota the result is almost the same as the first method described. The major weakness in a plan of this kind lies in the difficulty in adjusting the quota so as to give the salesperson a reasonable goal to reach and at the same time not make it possible to reach without some exertion. If the salesperson fails to make the quota one week it may be allowed to run over until the end of the month. One advantage of this method is that the salesperson will attempt to make sales during the whole month. It is generally accepted that four weeks or an even month is a better period to establish a quota than a week, as it gives a better opportunity for the law of averages to work out. Some stores feel that this plan is too complex to be readily understood by the average salesperson, and for this reason a straight wage is paid. Furthermore, they feel that there are too many calculations in arriving at the quota and the total salary of individual salespeople, so that the expense of operating may be greater than the results obtained. However, in stores where the quota plan has been in operation for some time the increased production has more than counterbalanced any increased expense due to calculating individual salaries.

Salary and bonus.—Under this plan the employees receive, in addition to their regular salary, a certain amount of money, called a bonus, given at different intervals as every three months, every six months, or once a year. Some stores offer it as a Christmas gift either in the form of money or in shares of stock. The bonus may be based on length of service in the store, salary received, or an increase in sales volume over planned. In general, store workers regard the bonus as a gift over which they have little or no control. If it is to be effective as a selling stimulus it should be given at short intervals and earned by exceeding a set standard or quantity of work. As a general rule, the basis upon which the bonus is paid is not thoroughly understood by the employee, and for this reason it is not as effective as the bonus-commission plan.

Departmental bonus.—In order to promote team work some stores fix a quota for the department as a whole, paying each employee a percentage above this quota. This type of incentive encourages better care of stock, more attention to

customers in making adjustments and returns, and decreases friction between employees, due to the recognition that all salespeople within the department gain from the results. This bonus may either supplement the individual bonus or it may be used without individual quotas. This type of bonus is especially effective in departments where individual service must be given to customers, or in departments where certain merchandise is easier to sell than others, as it eliminates the necessity of moving the salespeople about in the department in order to give each an advantageous location. For instance, in the men's furnishing department, it is usually more difficult to make the quota in collars than in shirts, so that an individual quota must be made for each line of merchandise, or the salespeople alternated in selling at the different counters.

Profit-sharing.—In some stores employees are paid in addition to their regular wage a share in the net profits of the concern. The basis upon which these amounts are paid may be the sales volume of individual salespeople, length of service, or the amount of salary. Theoretically, this method of payment brings the interests of the employee in line with the interests of the store and thus discourages inefficiency. In actual practice, however, the method of arriving at net profits is not readily understood by employees, and there is a tendency for this system to cause dissatisfaction, because a large number of the factors which contribute to net profit are beyond the control of the employees. Furthermore, the method is too indirect to be an effective incentive. The management must either make known the actual profits of the store or merely set aside an arbitrary amount to be distributed among the employees. In the former case the workers will know just what the financial status of the concern is at least once a year. In a great many cases this is unsatisfactory, because of the general lack of understanding on the part of employees of the necessity during certain periods of the business cycle of setting up a surplus to counterbalance lower net profits during other periods. If an arbitrary portion of net profits is distributed, the incentive is less effective, because its basis cannot be explained. On the other hand, profit-sharing has a tendency to decrease labor turnover, inasmuch as the employee must remain with the concern in order to get this remuneration.

Stims and P. M.'s.—In order to increase the selling efforts of salespeople, an extra commission or premium is sometimes paid on certain items of merchandise. These commissions are known as "P. M.'s" (Premium Money), "Stims," or "Spiffs." They vary in proportion to the price of the item from five cents to as high as one dollar. Buyers recognize that the payment of ten cents for selling a pair of $7 shoes will have more effect in breaking down sales resistance than a mark-down of the same amount. In fact, experiments have shown that it is more effective to give a stim of ten cents than to take a mark-down of four times as much. As a general rule, however, stores have found that the use of stims or P.M.'s is not good merchandising policy. There is a tendency for buyers to attempt to cover up poor buys by encouraging salespeople to concentrate on them. The ultimate result is a loss of sales due to insistent selling, attempts at substitution, and dissatisfaction on the part of customers because of unsatisfactory purchases.

A far-sighted merchandising policy should protect the customer against the purchase of merchandise which is unseasonable or which for other reasons will not be satisfactory in use. In a large number of cases stims or P. M.'s place the interest of the salesperson first and disregard the interest of the customer. On the other hand, there are cases where the payment of extra commission is justified: for instance, in the introduction of new lines and higher-priced merchandise which have real value, but which is slightly more than the store's clientele is in the habit of paying. It is the function of the retail store, through its salespeople, to bring these values to the attention of its customers and, unless some special stimulus is given, salespeople will follow the course of least resistance and sell the old lines. Although a great many stores are using stims or P. M.'s, there is a tendency to apply them only to items which have real value rather than to use them to move old or unseasonal merchandise.

Adjustment of quotas.—The effectiveness of a quota plan depends to a large degree upon the method of adjusting it to meet the changes within the store or department, such as absences and vacations of salespeople, transfers, Christmas help, and contingent salespeople. Since one of the principal advantages of the bonus plan is to encourage decreased

absences, the quota usually should not be reduced because of the employee's absence. The knowledge of the individual that absence affects a possible earned amount should have its own effect. It is open to debate whether the quota should be adjusted because of vacations. If the quota is on the basis of four weeks and an employee is absent one week, the quota should certainly be decreased by one fourth, if it is to function as an incentive to increased production. However, some stores feel that, if the vacations are properly scheduled, the quota for the month should not be reduced, as the sales for the salesperson would be automatically increased, because of the absence of other salespeople from the department, resulting in a fair condition to all.

In the case of transfer of salespeople, adjustment in quota should be made only if the transfer is permanent, as ordinarily the switching of salespeople for special sales will more or less equalize by departments within a given period. In some stores salespeople not regularly employed are used during special events or emergencies and are assigned to several departments within a bonus period. As a general rule, the quota of the departments in which they work should be applied to them. Inasmuch as Christmas help is temporary, it is difficult to arrive at an equitable basis for determining the quota. Also, the inability immediately to remunerate this type of salesperson often causes both misunderstanding and confusion. On the other hand, a salesperson employed for a short period must be given a wage stimulus, if the store is to get maximum production. In some stores, an effective incentive is given by employing extra help with the understanding that, if their sales and work are satisfactory, they will be retained in place of other employees who are less productive.

Payment for absences.—As a general principle in the smaller store absences should be paid for, and the period of time allowed should be decided on individual merit. In larger organizations, where the number of employees permits the carrying out of the plan, a mutual aid or benefit society is often organized. The employee thus contributes to a mutual insurance fund, and does not feel in any way that it is charity. So far as possible these organizations should be self-sustaining, the store contributing only to the deficit resulting from their operation. Such plans eliminate individual misunderstanding,

and the possibility of misapplication of the absence privilege. If thoroughly understood by all, such plans should contribute to the productiveness of the store as a whole.

Although there is no standard of practice in paying employees for absences due to vacation, there is a general tendency, especially among the larger stores, to allow a vacation, the length of which is based upon length of service. In an investigation of 875 stores made by the National Retail Dry Goods Association, it was found that 12 per cent do not allow vacation, 50 per cent allow one week with pay, and 38 per cent allow two weeks with pay. Those not allowing vacation are principally stores doing a business of less than one million dollars annually. Thirty-one per cent of the group require employees to be in their employ at least six months before earning a vacation, while 60 per cent require one year of service before any vacation is allowed.

The primary purpose of giving a vacation with pay is to increase the *esprit de corps* of the personnel, decrease absences which are unauthorized or unscheduled, and increase the general productivity of employees by giving them an opportunity to rest and build up their mental and physical vigor. It is necessary, therefore, first thoroughly to explain the vacation plan, so that the employee will appreciate its meaning. It should be adjusted in accordance with the general practice of the locality. Goodwill results only when the plan has particular advantages in comparison with plans used by other local firms. Secondly, if the vacation plan is to reduce irregular absences, a certain standard of attendance over a period should be made a requisite. In the third place, if the plan is to increase production, a schedule should be worked out so that the majority of employees will take their vacations during the period in which the sales of the store are low. A few of the larger stores have worked out a schedule for each department, so that there may be an even distribution of absentees and that the production of the departments is not materially decreased. These schedules require a mutual consideration of the interests of the store and the individual employee. A fourth and final factor in a vacation plan is that, in so far as possible, the employee should take his vacation in a manner that will give him a maximum of recreation for the period. Stores in larger cities have developed vacation camps for this purpose.

Discounts to employees.—Most stores grant a discount, varying from five to twenty-five per cent, to employees on purchases made in the store. In a majority of stores, however, the discount is ten per cent, granted on all purchases of the employee for his own use or for that of his family dependent upon him. Some firms grant a discount of twenty per cent on all clothing which comes under the dress regulation of the store. There are two major purposes in granting this discount. First, to get employees to trade with their own store rather than with some competitive store. A store is in a sense buying the employees' goodwill. Unless a special price is offered they are just as apt to buy their merchandise in another store. Since there is no advertising expense incurred in bringing the merchandise to their attention, the actual expense of the sale is not so much as to an outside customer. The second purpose in granting a discount is to give the employee an extra remuneration. Although most stores do not include the amount of the discount as a part of the employee's wage it is in reality a form of pay.

A 20 per cent discount on wearing apparel means only that the total discount to employees from all departments will be taken in the departments carrying wearing apparel. If the discount is made for the goodwill of employees, or as added compensations, then all departments should bear this discount on the basis of actual purchases made by the employees of their departments, or the average payroll of the individual departments. One store has the policy of charging all employees' discounts to a special account and crediting each department with the amount of the discount. This special account is then distributed to all departments on the basis of the amount of payroll. In this way the departments carrying wearing apparel bear only their proportionate part of the total discount rather than all of it. By some stores, the discount is given as a means of promoting sales. In these stores it is believed that the discounts increase sales directly through the purchases of employees and indirectly through friends and customers of employees. For this reason, the discounts are treated as mark-downs, the same as discounts to special classes of customers. In these stores the discount is subtracted from the gross retail price on the sales check and the employee pays the net amount.

Non-selling personnel.—The common method of payment of non-selling personnel is a straight wage. In some stores, however, a bonus plan is used in several major groups of non-selling employees, such as cashiers in tube rooms, sales auditors, billers, authorizers, accounts payable figurers, markers and checkers, wrappers and packers, drivers, mail openers, and sorters. The general principles of a bonus plan in the non-selling departments are the same as that for salespeople. In the first place a thorough study is made over several years of the production per individual in the different departments, and on the basis of this study a standard of performance is set which corresponds to the quota in the selling department. Above this quota a bonus is paid in proportion to performance. For instance, in the tube-room department one store set a quota of 700 as the number of sales checks which should be handled by each cashier. Each cashier was paid a base salary and a bonus of 20 cents for each 100 checks above the quota. As a result of the introduction of this method of payment the production in the department was increased about 50 per cent during one year. The general principles of a bonus of this kind are similar throughout the whole store.

In some cases, a standard of performance is established for the whole department. For instance, in the mail-sorting department of one store each girl is credited with $5 at the start of the month, and a time limit within which the mail must be prepared for distribution is set. Fifty cents is deducted from each girl's account whenever the group fails to complete the work within the time limit. Whenever a girl is late 50 cents is also deducted from her bonus. It is seldom in this store that a girl fails to get the mail out within the interval allowed. In this plan adjustments are made for absences due to illness and vacation. When this plan was first put into operation it took 17 or 18 girls two hours to do the work and at the end of the first year from 10 to 14 girls could complete the job in half the former time.

The first essential in the establishment of a bonus plan of this kind is that the standard of performance should be at a point that will require a reasonable amount of effort to reach. Special attention should be paid to this point, because in the actual experience of different stores, the first standard set is usually too low, resulting in too large a proportion of wages

being paid in bonus. For instance, in the case mentioned above, a quota of 700 sales checks was first set, but at the end of three months the average number per individual was 950 and some of the cashiers were doing as high as 1,200, thus making $1 per day bonus besides their base salary. As a general rule, the bonus plan gradually increases production. It is difficult, however, to increase the quota or decrease the bonus rate, because of the ill-feeling which it causes on the part of employees. For this reason most stores have found it advisable to allow a reasonable margin of safety for increased production in fixing the quota, and to fix it definitely for a certain period, making it clearly understood that at the end of this period it may be raised or lowered.

Cost of Selling.

The wages of salespeople constitute about one fourth of the total expense of the retail store. This expense percentage can be lowered only by increasing the productivity of the sales force. Investigation of the output of salespeople shows that their sales vary greatly in different stores, even in the same department. The following ranges are given as typical of this variation in weekly sales and percentage of selling costs in representative departments of a department store.

	Weekly Sales	*Selling Costs*
Women's dresses	285 to 660	2.5 to 5.4
Women's coats	420 to 975	2.5 to 5.8
Infant's wear	220 to 395	4.5 to 8.5
Silks	445 to 830	3.4 to 5.5
Hosiery	375 to 660	3.2 to 5.5
Notions	175 to 325	5.25 to 9.0
Millinery	225 to 355	5.8 to 7.9
House furnishing	200 to 500	5.3 to 8.1

In the retail grocery trade in 1922, an analysis of the reports of 424 firms showed the results given in Table 24, page 259. As these figures show, for a typical firm with net sales of $90,000 that secured an average sales volume per salesperson in excess of $15,000 in 1922, the total salaries and wages amount to $8,100 as compared with $11,700 for a firm with equal sales volume, but whose salesmen made an average of less than $9,000. It is obvious that high sales volume per

TABLE 24

AVERAGE ANNUAL SALES PER EMPLOYEE IN RETAIL GROCERY STORES IN 1922 *

Average Annual Sales per Employee	*Number of Stores*	*Total Salaries and Wages (Percentage of Net Sales)*
Less than $9,000	75	13.0
$ 9,000–$10,900	99	11.5
11,000– 12,900	101	11.0
13,000– 14,900	65	10.9
15,000 and over	84	9.0

* Bureau of Business Research, Harvard University, *Bulletin No. 35.*

salesperson effected large economies in this group of stores. In the retail shoe trade, a similar relationship is shown between the percentage of salary and wage expense, and sales per salesperson. The data in Table 25 show the result of an analysis of 203 retail shoe stores:

TABLE 25

AVERAGE ANNUAL SALES PER EMPLOYEE IN RETAIL SHOE STORES IN 1922 *

Average Annual Sales per Employee	*Number of Firms*	*Total Salaries and Wages (Percentage of Net Sales)*
Less than $8,000	35	17.3
$ 8,000–$10,900	83	15.8
11,000– 13,900	75	14.3
14,000– 16,900	45	14.1
17,000 and over	64	13.1

* Bureau of Business Research, Harvard University, *Bulletin No. 36.*

The common figure for wages of the sales force in department stores under $1,000,000 was 7 per cent in 1923 with a range from below 5 per cent to more than 10 per cent. For the same year, department stores over $1,000,000 had common figures of 5.9 per cent for direct-selling salaries and wages. As shown by the figures above, a typical store with sales of $500,000 in 1923 had an expense of $35,000 for the salaries and wages of its sales force.

While these wide differences in the individual productivity of salespeople can be explained in part by the size and location of the department or store, and the type of merchandise carried, nevertheless, investigation has shown that much of the

low productivity can be overcome by an adjustment in the method of pay. If possible there should always be a direct causal connection between what the employee does and his remuneration. This relation can best be established by means of some kind of commission or bonus plan as a basis for his wage, and a concrete schedule of promotion. The more definite the pay and the more immediate the reward, the more effective is the system. Although the exact method of stimulating the employee varies with conditions, the principles are fixed, because they are founded on the innate tendencies in human nature itself.

Buyers' compensation.—The problems involved in determining an effective method of paying buyers are similar to those of paying salespeople and the bases practically are the same. The most common practice of stores is to pay the buyer on the basis of the successful operation of his department. Stores vary widely, however, as to what constitutes successful operation. The common practice is that of paying buyers a base salary plus a bonus in the form of a commission on net sales above a quota. This quota is determined by the past experience of the store, the internal conditions of the departments, and general economic conditions as affected by the business cycle. Although this method of paying a buyer offers a direct incentive to increase sales, there is a tendency to increase the volume without sufficient attention to a proper net profit. A similar method is paying a percentage on sales increase over the corresponding previous period. Some buyers are paid in addition to a base salary a percentage on gross margin or maintained mark-up above a certain set percentage. This plan induces the buyer to work for as high a maintained mark-up as possible. Such a plan may defeat its purpose by decreasing sales through too high a mark-up percentage. In order to coördinate the interests of the buyer with those of the management some stores pay a percentage of net profit. These stores feel that this method of payment will cause the buyer to give the proper attention to initial and maintained mark-up, inventory shortage, sales volume, and rate of stock turn. On the other hand, some stores feel that the buyer has little or no control over a great many of the factors which contribute to net profit, such as general administrative and fixed expenses. They feel that the method of distributing such expenses as rent

and delivery would cause friction and dissatisfaction among buyers. However, unless the individual department manager or buyer is imbued with the idea of operating his department as though it were his own, final net profit will usually be unsatisfactory to the organization as a whole. To adopt this viewpoint also insures the cultivation and education of the department manager in the various things that go to make up a successful department. This viewpoint particularly applies to the effect of the initial mark-up and the subsequent effect of reductions and shortages. It encourages a thorough study by the buyer of the effects of turnover on net profit and the result of elimination of undesirable and slow-moving stock. Since the measure of successful operation of a department is net profit the buyer should be given a direct incentive to increase this figure.

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Problems.

1. The Durwell department store has twelve salespeople regularly employed in its ready-to-wear department. The total annual volume of sales for the store is about $10,000,000. In one of the weekly merchandise meetings the buyer of the ready-to-wear department made the statement that Miss Brown, one of her salespeople, was invaluable to the firm. The controller questioned the statement of the buyer, saying that he did not think Miss Brown was as valuable to the store as other salespeople in the department. This discussion led both the buyer and the controller to investigate the productivity of salespeople in the department. It was found that Miss Brown had an average weekly net

sales of $650; an average sale of about $23 and returns amounting to 12 per cent of her net sales.

It also developed that she secured much of her large volume of sales by selling marked-down merchandise, which required little or no sales effort and carried no net profit. On the other hand, Miss Powell, another salesperson in the department, had average weekly net sales of $550, an average sales check of $48 and only 3 per cent returns. At this time the salespeople in the store were paid a weekly salary that was determined at the time they entered the employ of the firm. In addition to this salary each salesperson received a commission of 3 per cent of the amount by which her net sales for a given week exceeded her quota for that week. The quotas were determined by dividing average selling costs into the weekly salary of each salesperson. When it became clear to the controller that this method of payment was leading to unjust appraisal of the worth of salespeople he brought the matter before the board of directors. The board desired to make a change in the method of payment and asked the controller to present a plan which he felt would give a just evaluation of the worth of each salesperson.

(*a*) What method should he have devised?

(*b*) It was suggested that twice the amount of returned merchandise be subtracted from gross sales in arriving at the net sales of each salesperson. Should this suggestion be adopted?

2. The Marsh department store is located in a city with a population of approximately 1,000,000. Its sales volume in 1923 was $10,000,000. This store caters to a medium- and high-class of trade and does a credit business of approximately 70 per cent. The salespeople are paid a straight salary throughout the store, but there has recently been introduced a supplementary incentive in the form of a premium for selling certain articles of merchandise. In the piece-goods department a 5 per cent extra commission is paid on all remnants. In the men's furnishing department 10 cents is paid on all shirts over four dollars. In the shoe departments the premiums range from 5 cents to 75 cents on certain lines of slow-moving items. Since the introduction of the premiums the percentage of returned merchandise has shown a slight increase.

(*a*) Should salespeople be paid a premium for selling certain items of merchandise?

(*b*) The wages of salespeople in the Marsh store are adjusted every six months on the basis of the sales for the corresponding six months of the previous year. For example, the selling costs are arrived at by dividing the total selling

payroll of the department by the total sales. By applying this percentage to the sales of each salesperson the total salary is determined for the next six-months period. Thus, the sales of each salesperson for the last half of 1923 determine his salary during the last half of 1924.

What are the particular advantages and disadvantages of this method of adjusting wages?

(*c*) The controller of the Marsh store reported that the direct-selling costs were 6.9 per cent of net sales. How does this percentage compare with that reported by the Harvard Bureau of Business Research?

3. One of the leading department stores of Metropolitan New York has recently employed a woman to work out a series of pre-employment tests to be given to applicants for selling positions.

What qualifications may be determined by such tests?

4. The educational director, Miss Nash, of the Marsh department store, has emphasized the use of merchandise manuals in each department of the store. Since 1921 Miss Nash has supervised the writing of manuals for 32 of the 56 departments of the store. In so far as possible each of the manuals includes only the information which a salesperson needs in selling the particular merchandise of the department. For example, in the knit underwear department the manual contains: (1) a brief description of the materials used in the manufacture of knit underwear; (2) the process of manufacture and the workmanship which gives wearing qualities to the garments; (3) general instruction regarding the care of the goods such as limitation in washing, wearing, etc.; and (4) some of the common objections which salespeople meet in selling.

In the early part of 1925 the Marsh store changed merchandise managers and the new merchandise manager is very much opposed to any form of manual for salespeople. He feels that it is the duty of buyers to hold regular meetings with the salespeople of their departments. In these meetings he contends that the information regarding the merchandise can be given to the salespeople more effectively. Furthermore, he feels that the materials, processes of manufacturing, and the general value-giving quality are changing so rapidly that a large part of a manual is practically obsolete in a very short time. Miss Nash feels that if the assumptions of the new merchandise manager are accepted by the general manager her position, except as a systems teacher, will be practically eliminated.

How should salespeople be instructed regarding the selling points of the merchandise within their departments?

Chapter XI

ADVERTISING

Two important elements in retailing are merchandising and advertising. The former is concerned with moving goods toward the consumer; the latter includes all non-personal methods used favorably to influence customers toward a store. The aim of advertising is to bring to the attention of buyers the merits of particular commodities and services which the institution renders, as a means of stimulating sales and of increasing prestige. It comprises such types of visual salesmanship as window and store display, magazine and newspaper advertising, posters, street-car cards, catalogues, circulars, and electric signs. The real selling force of an advertisement, as in personal salesmanship, lies in the effectiveness with which buying motives are aroused. It is addressed to a local clientele and, as a general rule, aims to secure immediate response. Department stores and specialty stores are the heaviest advertisers, and their advertising is essentially merchandising news.

The function of advertising, in the larger stores, is performed by a staff organized along the lines shown in Figure 36. The director of sales and publicity is responsible for all the sales planning and for actually securing the increase in the year's business. Aside from sales planning, his most important function is the coördination of merchandising and publicity functions, working with the merchandise manager in planning and executing sales events. In some stores the person who performs these functions is called the sales promotion manager or the publicity director. In other stores the activities of merchandising and advertising departments are coordinated by a member of the firm or by a merchandise council.

The advertising manager is responsible for the preparation and the appearance of all printed publicity matter issued and

run by the store in any medium, the purpose of which is to attract people and to bring them into the store. It is his function to coördinate the work of the buyers of the various departments as to quantity and policy of advertising. In most stores he is directly responsible for the discipline, control, and production of the advertising division. In the larger stores, the advertising manager usually has two assistants, one in charge of newspaper advertising and the other in charge of direct mail. The display manager may be responsible to the

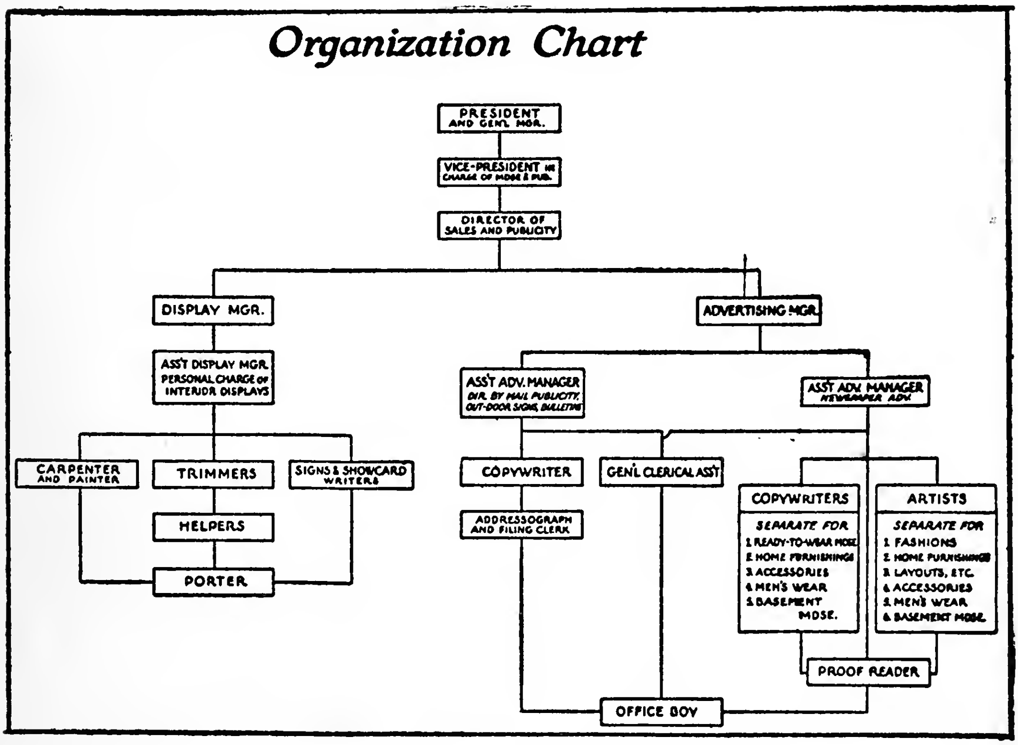


Fig. 36—Organization Chart.

publicity director or to the advertising manager. In either case he is in charge of all interior and exterior display. Exterior display usually includes the portrayal of the store and its merchandise to the public in outside exhibits and in fashion shows. The advertising staff includes copy writers, artists, proofreaders, window trimmers and general clerical assistants. In some stores the advertising manager is made subordinate to the merchandise manager, and on a par with the divisional merchandise managers. The general tendency, however, in the larger stores is to place the merchandise manager and advertising manager on a par and to coördinate their

functions by placing them both under the general manager, or sales or publicity director. The relation between advertising and merchandising is especially close, but the question whether the advertising department is to be subordinate to the merchandise division, or on a par with it, will depend almost entirely on personal factors. The fact should not be lost sight of that advertising is a method of sales promotion and not entirely a separate function in itself.

The fundamental problems of advertising.—The problems of the advertising staff naturally divide themselves into three major classifications: (1) the selection and the checking of information and statements, to maintain the customer's confidence; (2) the planning or budgeting of advertising expenditure, to get timeliness and distribution through the most effective media; (3) the determination of, and conformance to, a fixed policy. Although the determination of policy is the first consideration in the actual advertising of a retail store, it is treated last in this discussion, that those unfamiliar with the problems of advertising may see the fundamental reasons for a uniform policy. The selection and the checking of advertising information are primarily routine in most of the larger stores, and depend more or less upon the type of organization and the responsibility of the advertising department. The planning and the budgeting of advertising expenditure are closely related to the merchandise policy. This expenditure may be planned only after the proposed aims of advertising have been clearly defined. In some respects the policy upon which advertising plans and methods are based is the most fundamental thing to be determined. A detailed statement of policy would mean a complete answer to each of the many questions arising out of the two fundamental problems already stated.

Selecting and checking information.—Merchandise information originates with the buyer. In the larger store, the common procedure is for the buyer to submit a rough draft to the advertising department on a form showing the merchandise to be advertised, the particular value-giving qualities which may be used as an advertising appeal, and the general information called for on request for advertising forms (Figures 37, 37a). A sample of the merchandise to be advertised should accompany the request for space, that the advertising

manager may check the statements of the department manager and have cuts made if the items are to be illustrated. As a general rule merchandise and copy are checked by the comparison department before the advertisement is inserted, that it may be compared with that which appears from other stores. This is especially emphasized by stores whose policy it is to undersell competitors in comparable merchandise. It

REQUEST FOR ADVERTISEMENT

To Be Published ____________________
(State Day and Date advertisement is to be inserted)

Department No. ____________ Date Sent to Advertising Department ____________

Total Amount of Money Involved ____________

Quantity of Merchandise ____________

Can more be obtained? ____________

How many items are to be illustrated, if any? ____________

State what newspapers you prefer ____________

Specify date of follow-up, if any ____________

Indicate By Checking Whether This Is:

- [ ] Special Purchase
- [ ] Reduction on merchandise in stock
- [ ] Regular stock at usual price

Samples

Samples of merchandise to be advertised must be sent to Advertising department with Copy. When illustrations are desired, samples must be sent to the Advertising Office at least one week before the advertisement is to appear.

Former Prices

In every instance of reduced prices, our former prices must be stated.

ADVERTISING SCHEDULE

Copy For	Must Be Submitted By:	
Monday	Wednesday	At 12 Noon
Tuesday	Thursday	At 12 Noon
Wednesday	Friday	At 12 Noon
Thursday	Saturday	At 12 Noon
Friday	Monday	At 12 Noon
Sunday	Tuesday	At 12 Noon

Copy To Comparison Office

This sheet must be submitted to Comparison Office to be signed by its authorized representative before it is taken to the Advertising Office.

A duplicate of this sheet, together with samples of merchandise must be left with Comparison Office.

____________ Assistant Department Manager's Signature

____________ Department Manager's Signature

Fig. 37—Request for Advertising.

is generally recognized that an appeal is strong or weak only in comparison with other appeals or with the customary impressions which the reader has. So far as possible the comparison department anticipates the customer's impression when the advertisement is read, and then determines whether merchandise advertised is actually in line with these impressions. An advertisement which causes a customer to expect more than she will get may increase the store's traffic for a while, but its pulling power will suffer. Most stores require the

buyer to sign a proof of the advertisement (Fig. 38), before it is released, certifying that it is truthful and free from typographical errors. As a general rule, the advertising manager is held responsible for the statements made in advertising, but he in turn holds the buyer responsible for the facts.

It is the function of the advertising department to present

SCHEDULE FOR ADVERTISING

IMPORTANT NOTICE—To be entitled to insertion on the date desired, copy must be brought to Division of Publicity BEFORE 10 A. M. on the days specified.

Advs. for Newspapers of	Must Be in Division of Publicity BEFORE 10 A. M. on
Sunday for Monday	The Preceding Monday
Monday for Tuesday	" " Tuesday
Tuesday for Wednesday	" " Wednesday
Wednesday for Thursday	" " Thursday
Thursday for Friday	" Friday
Friday for Saturday	" " Saturday

Request for Advertising, for insertion on________________192__

NOTICE

In round figures indicate how much goods you have behind this advertisement.

$________________

This space must positively be filled in.

Quantity in Stock—

Last former Selling Price, if reduced—

WHERE WILL THESE GOODS BE SOLD ?________________

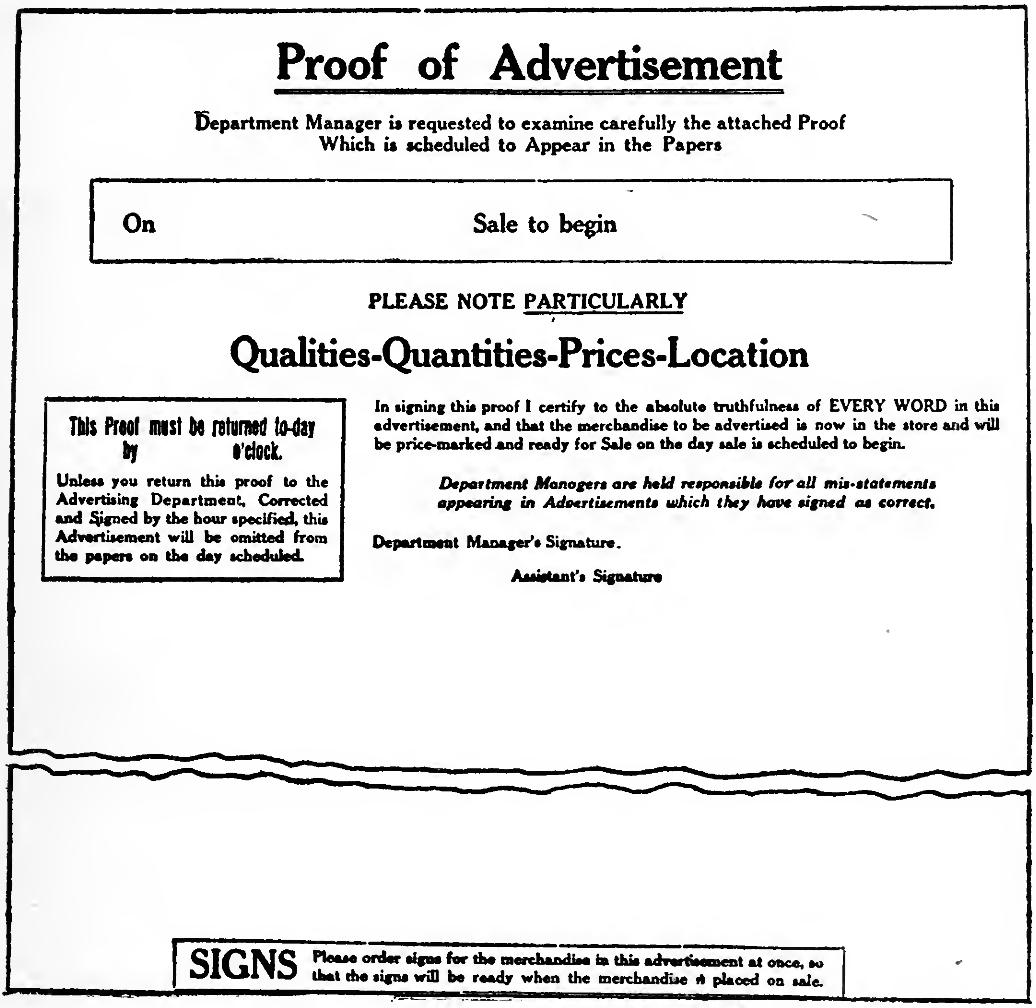
Head of Department (Please Sign)

QUANTITY, last former selling price, location and Buyer's signature MUST all be filled in before Advertising Department can accept this copy.

Fig. 37A—Schedule for Advertising.

the value-giving qualities of the merchandise by means of copy, illustrations, and typography, to get the most effective appeal in conformance with the policy of the store. The copy may be written by the buyer or by the advertising staff. Inasmuch as it requires special training, most stores have found it advisable to have the buyer present only the facts regarding the merchandise and to make the advertising department respon-

sible for the presentation of the facts in an effective manner. This makes possible a uniform policy and style throughout the store. Furthermore, it is felt that the selection and the presentation of value-giving qualities in an effective appeal are entirely separate and distinct functions, requiring a different training and technique.



Proof of Advertisement

Department Manager is requested to examine carefully the attached Proof
Which is scheduled to Appear in the Papers

On Sale to begin

PLEASE NOTE PARTICULARLY

Qualities-Quantities-Prices-Location

This Proof must be returned to-day
by o'clock.

Unless you return this proof to the Advertising Department, Corrected and Signed by the hour specified, this Advertisement will be omitted from the papers on the day scheduled.

In signing this proof I certify to the absolute truthfulness of EVERY WORD in this advertisement, and that the merchandise to be advertised is now in the store and will be price-marked and ready for Sale on the day sale is scheduled to begin.

Department Managers are held responsible for all mis-statements appearing in Advertisements which they have signed as correct.

Department Manager's Signature.

Assistant's Signature

SIGNS Please order signs for the merchandise in this advertisement at once, so that the signs will be ready when the merchandise is placed on sale.

Fig. 38—Proof of Advertisement.

Errors.—Even with the most accurate check, errors creep into advertising. In a New York store forty \$197 rugs, through an error on the part of the newspaper, were advertised at \$1.97. In a St. Louis store, evening coats were advertised at \$1.45 instead of \$145. In both these instances the store refused to sell the merchandise. Due to an error on the part of the advertising department, a store in New York advertised one hundred doll carriages for \$2.44 instead of

$5.48. The advertisement appeared in only one issue of the afternoon edition of the paper and was later corrected. Although the policy of the store required that the proof be signed by the buyer, the advertising department in this instance had released the copy without his signature. Consequently, the buyer refused to sell the carriages unless the advertising department stood the loss. The result was that the customers were informed through the salespeople that there had been an error in the advertising and that the price of the carriages should have been $5.48. It is questionable whether, in a case of this kind, it is good policy to refuse to sell, because of the ill will which results on the part of the customer who conscientiously believed the merchandise was to be sold at the low price.

There are two major factors to be considered, when an error has been made, in determining what policy to pursue. One is the immediate loss in dollars of the difference between the actual price and the advertised price; the other is the loss of goodwill if the store refuses to sell. The former is tangible and may be given undue weight as compared with the latter which, to a large degree, is intangible and of future significance only. It is the general consensus of opinion that in any case in which the customer might reasonably expect the merchandise as described could be sold for the advertised price, it is good policy for the store to take the loss and sell the merchandise as advertised rather than try to explain the error. On the other hand, it is equally good policy to refuse to sell in cases where the error is such that the customer could not reasonably expect a sale to be made; in other words, if the error is obvious. If a customer insists upon buying at the erroneous price it shows that she is unreasonable and her goodwill is not of material advantage to the store. The decision in a case of this kind is merely a matter of policy, as the store is not legally bound to sell any of the merchandise offered in newspaper advertisements.

Advertising schedule.—The majority of the stores work on an advance schedule for advertising made up several weeks ahead of publication. In some stores a six-months plan is made of the major sales events and the minor events scheduled a few days in advance. The following plan, used by a New York department store, illustrates the common pro-

cedure in planning and distributing advertising space. This plan provides for holding a semimonthly conference on advertising planning attended by the general merchandise manager, publicity director, and the seven divisional merchandise managers. The divisional merchandise managers bring to the meeting the selling problems of the departments in their respective divisions and make requests for special space for large events of departments under their supervision. Public demand, planned figures, weather conditions, and all factors of coördination of store activities are considered in drawing up the advertising plans for the next two weeks. When the meeting ends, each merchandise manager knows exactly how much space he is entitled to for the next half month. He also knows the days that have been assigned to his departments for featuring certain classes of merchandise. This information is then taken by the merchandise managers to divisional meetings, with their own buyers, where it is distributed in conference to the different departments. Special consideration is given to those departments that need promotion or that have been especially fortunate in their purchases for the period.

This method of apportioning advertising space gives an opportunity for division merchandise managers, through the conference, to get a better understanding of the problems and activities throughout the store. It helps to coördinate the store's advertising and provides a uniform policy throughout. This periodic general conference offers an opportunity to the advertising manager to bring before the merchandise managers instances of undesirable practices. Since decisions are reached at the general conference in open meeting, there is eliminated any friction because of dissatisfaction among division heads. Another advantage in a plan of this kind is that the advertising manager deals with seven merchandise managers rather than individually with seventy buyers. This provides a more systematic procedure in handling advertising problems. It places advertising planning on the same scientific basis as merchandise planning. Furthermore, it is felt that, since the divisional merchandise manager coördinates the buying activities of the buyer, he should in turn supervise and coördinate their sales and selling plans.

In many stores the buyer is a part of the merchandise division in his purchasing, and must have the approval of the

merchandise manager to buy goods; but in selling them he works individually with the advertising manager. The size of the store and its general policies will determine the procedure in coördinating the advertising and the sales of the different departments. The tendency, however, is toward divisional control of sales as well as purchases. Figure 39 gives a form of advance sales chart showing the daily advertising plan used by one store covering an entire month. The method of planning advertising varies with distance from the central market. The following plan is used by a store near New York City:

"To begin at the very beginning, every buyer in the store is furnished with a full record for six months of his own and

Advance Sales Chart for Advertising

Schedule for *August* **NOTE:** Merchandise Men will be Held Responsible for the Truthfulness of all Statements Concerning Prices, Quantities, Colors, Sizes and Quality of Merchandise Supplied in Advertising Data Merchandise Mgr. *Jones*

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
Monday	Tuesday	Wednesday	Thursday	Friday	Saturday

Fig. 39—Advance Sales Chart for Advertising.

his competitors' events for the corresponding period last year. These records are furnished by the publicity department. The statistics for the February-to-July period are received on January 1. Those for August-to-January, on the first of July. Between January 1 and January 15, the buyers will discuss thoroughly with their respective merchandise men just which events of last year will be met and which events of their competitors they will anticipate. On the 15th the merchandise men discuss with the sales or publicity director the plans decided upon with the buyers, which are either adopted as presented, modified, or amplified, as the case may be. Perhaps, if a department program seems weak, the sales director will suggest the introduction of a new event. The plans as O. K.'d are then returned to the buyers, who go into the market and prepare in accordance with their schedule. Plans, which include day of advertising, duration of event, amount

of advertising space, window display, selling space, and so forth, are made for the entire month of February. On February 15 they are made for the month of March, and so on.

"The sales director then transmits the advertising schedule to the advertising manager and the space for the month is next laid out. Similarly, the display manager is advised of the part he is to play in ample time to permit him to make his arrangements.

"Not infrequently, the advertising manager accompanies the buyer to the market. Our proximity to New York and Philadelphia makes this possible, and this latter plan has frequently been a source of inspiration to the advertising man.

"In due time the merchandise arrives. Models are sent to the publicity office for a threefold purpose. One group goes to the copy writer, the second group to the artist for sketching, the third group to the comparison office where the selling price, as well as comparative values to be quoted, are carefully shopped. Then follows the mechanical work of the advertising department in preparing copy, having proofs O.K.'d, and releasing the advertisement.

"This is the ideal which we try to live up to. Varying merchandise conditions sometimes upset the schedule. No rule in operation is ever made so iron-clad with us that it cannot be broken when conditions demand it."

Advertising expense.—The advertising expense includes all newspaper, periodical, and program space, street-car cards, billboards, catalogues, circulars, electric signs, novelties, and contributions that have a direct advertising value. It may readily be seen that this is only a part of the total publicity expense, which includes, in addition to the cost of space, all items pertaining to the actual production of the advertising appeal, such as salaries and wages of the advertising staff, supplies, professional services, and the like. The advertising expense varies widely in different types of stores and in different stores in the same group. The common figure for department stores with sales less than $1,000,000, reporting to the Harvard Bureau of Business Research, was 2 per cent for 1923 and 2.9 per cent for stores with sales of more than $1,000,000. In the former group were 403 stores reporting, of which 23 reported an advertising expense of more than 4

per cent of net sales, whereas there were 40 firms whose outlays ranged from 1.4 per cent to 1.5 per cent. In the latter group of stores were 163 firms, of which 11 reported expenses of more than 5 per cent and 6 less than 1 per cent. In other types of stores the expenditure varies from actually nothing in some very small stores to as high as 8 or 10 per cent on the part of other retailers. Stores in which the major sales are in convenience merchandise do a very small amount of advertising. In this group are included grocery, general merchandise, hardware, and drug stores. Figures recently obtained by the Harvard Bureau of Business Research, and based on a number of stores in each case, are shown in Table 26 below:

TABLE 26

ADVERTISING EXPENSE IN RETAIL STORES IN 1923 *

Net Sales = 100 Per Cent.

	Common Percentage Figure
Shoe stores	2.2
Grocery stores	0.3
Jewelry stores	2.8
Department stores	
Sales over $1,000,000	2.9
Sales under $1,000,000	2.0
Specialty stores	3.8

* Bureau of Business Research, Harvard University, *Bulletins Nos. 44, 47.*

The common figure for total publicity expense in 57 department stores reporting to the Harvard Bureau in 1923, with sales less than $1,000,000, was 3.3 per cent, and for 82 firms with sales over $1,000,000 the expense was 3.9. In three of the latter firms the total publicity expense amounted to over 7 per cent.

Advertising appropriations.—There are two general practices in the method of handling advertising expenses. The first is to total the amount which has been spent during a certain period and the second to set aside or appropriate a certain amount which the store plans to spend during the period. The former is a post mortem and the latter a forecast. The general practice among the more scientifically operated stores is to budget the advertising expenditure for a period of six

months or a year in advance, coördinating it with the merchandise plan of the store.

The basis of an advertising plan, therefore, is the planned sales for the period. After these figures have been arrived at, the next problem is to determine the ratio between sales and advertising expenditure; in other words, what percentage of net sales should be spent for advertising. This ratio can be approximated only by a consideration of past experiences and future merchandising plans. As with any other item of expense, the amount to be spent for advertising should be decided in accordance with the specific merchandising task that the advertising is expected to perform. The amount which a store is warranted in providing in its budget for advertising depends upon the economies that may be effected thereby in selling, or the advantages to be obtained by an increase in the volume of sales. It must necessarily be flexible to allow for conditions which cannot be foreseen. The actual percentage, therefore, is the problem of each individual store. It varies with the effectiveness with which the space is used, the nature of the merchandise, and the policy of the store. In a community in which a store must depend upon a stable clientele the percentage of advertising expense is in direct proportion to the satisfactory experiences which customers have had with the store's former advertising and merchandise. If it has built up a reputation for truthful and conservative statements, then its advertising ratio presumably may be low. On the other hand, if customers have found merchandise inferior to their expectations the response to advertising will decrease and the ratio will necessarily increase.

Another factor in determining the advertising percentage is the location of the store. If a store chooses a central location, so as to take advantage of traffic, it usually pays a higher rental charge and less for advertising. Again, if the store is new, or is not well established, it must necessarily make a relatively larger appropriation. Still another consideration in advertising expenditure is the nature of the merchandise carried. Specialty stores usually have a high percentage of expense, regardless of location, because of the necessity of calling repeated attention to the timeliness of style and seasonal merchandise. The common figure for 41 specialty stores which reported to the Harvard Bureau in 1923 was 3.8 per

cent of net sales, as compared with 2.9 for department stores with sales volume over $1,000,000. The value of most articles of ladies' ready-to-wear fluctuates from day to day, so that a store handling this type of merchandise must continually bring it to the attention of the customers. On the other hand, wash goods and house furnishings may be purchased at any time during the year and thus require less advertising. The total appropriation for the store as a whole is found by multiplying the net sales by the planned percentage of advertising expenses. The total amount in dollars should serve as a guide in planning the expenses by months and by departments.

In the larger stores a six-months plan is drawn up for each department, showing the estimated expenditure in percentage and actual dollars for each month. This plan is coördinated

ADVERTISING BUDGET

1	2	3	4	5	6	7	8	9	10
ADVERTISING MGR. & MERCHANDISER					OFFICE				
DEPT. NUMBER	NUMBER SPECIAL EVENTS	NUMBER REGULAR EVENTS	NUMBER INCHES	AMOUNT DOLLARS	PERCENT TO PLAN	PLANNED SALES	PERCENT ADVERTISING YEAR TO DATE	REVISED AMOUNT ADVERTISING	FINAL APPROVAL

Fig. 40—Advertising Budget.

with the merchandise plan for the period. In some stores a schedule of advertising events with space requirements is prepared by the merchandise and advertising managers, six weeks in advance, or on the fifteenth of the month, for use in the next month. These events are translated into dollars of advertising expense, including salaries and advertising overhead, and are submitted to the controller or financial officer of the establishment. This is compared with standards of advertising performance of past years and adjustments made. Figure 40 [1] shows the general plan for a budget of this kind.

The percentage of advertising expense varies widely between the different departments, according to the nature of the merchandise and the policy of the store. Advertising is used to attract people not only to the department but to the store as a whole. For this reason, the merchandise which offers the strongest pulling power should be given the greatest

[1] Controllers' Congress of the National Dry Goods Association, "Report of Fourth Convention."

amount of space. This is especially true in sales events when loss leaders are advertised in different departments of the store in order to attract trade. An interesting example of this is that of a New York store which has a yearly sale lasting one week, in which at least one article of each of 66 departments is advertised at a very low mark-up. In an analysis of the sales of one of these events, it was found that the total sales of the store for the week had been increased about 60 per cent over normal, and that only 25 per cent was in advertised merchandise, 75 per cent being non-advertised merchandise. In other words, the advertising had presumably attracted customers into the store, but the purchases in regular merchandise were three times that of advertised merchandise. Through an analysis of sales, department stores have found that less than one-third of all sales are in advertised merchandise. It is good policy, therefore, for a store to invest heavily in those departments that have a drawing power, so long as the average expense for advertising is kept within the planned figure. It must be remembered, however, that the average percentage for the store as a whole cannot be found by averaging the percentage of the different departments. Each appropriation must be reduced to a dollar basis and the total divided by the total net sales.

After the monthly advertising appropriation for the department has been made, it must be distributed to the different media, such as car and outdoor advertising, programs and magazines, window display, sign cards, direct mail, and newspapers. The figure for newspapers must be adjusted every few days. In distributing the appropriation to the different months a margin of reserve is maintained, that emergencies and unforeseen fluctuations in the volume of business may properly be met. Thus, for example, in the case of a business slump it may be desirable to spend a slightly larger amount than a direct uniform percentage would permit. Or again, in times of unusually large volume of business, the appropriation may be reduced below the specified percentage. Thus, when a store has a very large volume of business during the preholiday season, it may be advisable to decrease rather than to increase the advertising space or to stop advertising entirely in order that the traffic in the store may be decreased. On the other hand, the advertising appropriations may need to

be increased because of continued adverse weather conditions. For instance, during the opening of the spring season for men's straw hats, stores sometimes run two or three costly advertisements without any appreciable response. The fact that these adjustments must be made, however, does not detract materially from the desirability of having an advertising plan.

Measuring the return from advertising.—In the larger stores each department or line of merchandise is charged with all direct expenses for advertising and the indirect expenses prorated on the basis of sales. The direct expenses include the cost of space purchased in newspapers or elsewhere, rent for window space, and costs of sending direct mail and making display cards. The space which the name of the store occupies in an advertisement may either be charged directly to the departments advertised on the basis of space used, or to insti-

Merchandise	*Advertised*	*Space*	*No. Sold*	*Total Sales*	*Window*
$12.00 Hats	May 5	30 in.			no
Plaited Skirts		12 "			yes

Fig. 41—Sales Report from Advertising Department.

tutional advertising, and prorated to all departments on the basis of sales. If a store is to get accurate results from a measurement of the return from advertising, it should, so far as practicable, allocate this return to departments, as the result of specific investments which have been made. The response to newspaper advertising is to a large degree immediate, that is, a large percentage of it comes on the business day following the appearance of the advertisement. The common practice in measuring this response is to record the increase in sales over normal as due to the advertisement. The buyer is sometimes required to fill in "Number Sold" and "Total Sales" on a form (Fig. 41), which is attached to the clipping of the advertisement on file in the advertising department. Aside from giving a check on the pulling power of the advertisement, this method keeps the buyer informed of the cost of space used for his department in each advertisement.

In order to make a more accurate check on the actual merit of an advertisement, an estimation of the number of people

who were attracted to the department should be recorded. In other words, it is generally recognized that the ratio of people who purchase, to those who are influenced to come into the store, is a better index of the real strength of an advertisement. This is especially true in stores which must depend for the major portion of their trade upon a staple clientele rather than transient customers. There are many factors which tend to counteract the normal pulling power of an advertisement, such as adverse weather, the choice of the wrong media, the day of the week or month, the location of a department within the store, its general reputation for handling dependable merchandise, and the relative amount of advertising done by competitors. All of these factors are variable and must be taken into consideration in measuring the actual strength of any particular advertisement.

Another method of measuring the results of advertising is by interviewing customers after purchases have been made. If questions are properly systematized and the salespeople thoroughly instructed, valuable information may be obtained in this way. A store in Boston wishing to know, among other things, the extent to which the advertising is read prior to purchasing used the following questionnaire, which was printed and distributed among the salespeople. In obtaining answers to the questions several departments were selected each day, some of which had been advertised for that day and some had not. Each salesperson in that department was provided with a supply of these questionnaires and was instructed to put the questions to every fourth or fifth person, who came to purchase. The purpose of this was to get a representative sample of the total purchasers. The investigation was conducted over a period of ten days. A total of 5,325 customers were interviewed in this way and 5,298 questionnaires were secured filled in satisfactorily.

QUESTIONNAIRE *

Dept. Number *Number of Salesperson* *Date* *Name of Customer*

Address

1. Would you object to telling me whether you saw this article advertised? (The word "article" refers to whatever had been purchased.)

Yes *No*

* Daniel Starch: "Principles of Advertising," p. 920.

The salesperson would then explain as follows: The reason I inquire is because the ——— Company wishes me to ask if you would mind answering, if you have not already done so today, two other questions regarding the value of this firm's advertising to you. (Note: If the customer should inquire why these questions were being asked, you should answer, "We are trying to place our advertising announcements where they will result to the best advantage of our customers and ourselves.")

2. Do you read the newspaper advertisements before you go shopping?

Practically always *Usually* *Rarely* *Never*

3. What daily paper or papers do you read regularly?

After a customer has left, fill in the following from your sales slip, provided the article purchased was one she saw advertised.

Article Purchased *Amount* *Cash* *Charge*

The results for the upstairs division of the store and for the basement division were kept separate. The number of customers interviewed in the upstairs division was 3,895; and in the basement, 1,403. The results of the first question were as follows:

	Yes	*No*
Upstairs	14.1%	85.9%
Basement	40.5%	59.5%

According to these figures, only about one-seventh of all merchandise purchased in the upstairs store had actually been seen in the advertisements. There were many more people purchasing in the basement who had seen the article advertised than in the upstairs store. This was due, perhaps, to the fact that customers in the upstairs store do more general shopping and are more interested in merchandise that pleases them than merchandise at a price. A further comparison was made between the departments advertised and those not advertised. The results for the upstairs store only were tabulated from this point of view and were as follows:

	Yes	*No*
Articles bought which customers had seen advertised	18.9%	81.1%

The following data in answer to the second question show the extent to which women read the advertisements in this store before they go shopping.

	Upstairs	*Basement*	*Average*
Always	37.0%	56.7%	46.8%
Usually	38.5	31.5	35.0
Rarely	16.5	8.8	12.6
Never	7.9	2.7	5.3

The somewhat larger returns in the basement were due, in part, to a special sale that was advertised there during part of the period. They were also due, in part, to the greater bargain interest which the basement customers have.

The purpose of the third question was to determine what relation existed between the amount of advertising space carried in the various papers and the number of customers who read them. Consequently, the figures regarding the amount of space used in each of the papers were obtained, together with the circulation of each paper, and were compared with the proportion of the customers who read each. These figures are significant only for a given store and for a given period of time, and for that reason are not reproduced here. The facts are valuable as an aid in determining the relative value of different newspapers as advertising media. This investigation is presented merely to illustrate a method of approach in measuring the strength of advertising rather than to present the actual data obtained. The general tendency is for merchants to treat advertising expenditure as an investment, and to select space which will bring the largest relative return.

It is generally recognized that newspapers cater to different classes of people in exactly the same way as retail stores. For this reason, it is necessary for a store to select the medium which is read most extensively by the clientele to which the store is catering. If it carries low-priced merchandise, the advertising policy naturally will be to advertise in those media which reach the masses, and the copy must be written to conform to the general make-up of the paper. On the other hand, if the store sells on a quality basis, the advertising naturally should conform in make-up and media used.

Display.—Another method of influencing people to purchase is to bring the store and merchandise to their attention through window and interior display. The general principles of display are similar to those of newspaper and direct-mail advertising. The first essential is that the merchandise be displayed in such a way as to attract the type of customer to

which the store is catering in its other forms of advertising. The second essential is planning and scheduling the display to coördinate with that of the general merchandising and advertising program. In order that a uniform policy be maintained throughout the store and advertising activities coördinated, it is essential that all interior and exterior display be in charge of a display manager who is responsible to the director of publicity or to the advertising manager. Exterior display includes the portrayal of the store and its merchandise to the public in outside exhibits or fashion shows. In the smaller store the window trimmer should be directly responsible to the person who formulates the advertising policy of the store.

The display policy varies with the nature of the merchandise and the type of store. Stores handling convenience merchandise necessarily use the windows to call attention to as many different items of goods handled as may be effectively displayed. In this type of store the window is used to sell the merchandise displayed, whereas in a store catering to an exclusive trade the window display is used to create an impression or an atmosphere. If the store is emphasizing the price appeal in other forms of advertising and personal selling, it must necessarily display the price in its window, whereas, if style or quality is emphasized, the price, if shown at all, should be subordinated to the central idea of the display. This is in direct conformity to the general principles of all types of advertising.

Drug stores and cigar stores make effective use of windows in displaying merchandise which is not often associated with the type of store. For instance, in drug stores, necklaces, tea, coffee, and alarm clocks are often displayed. In an investigation carried on by an advertising firm on the selling power of window display, reports were received from about three thousand stores representing nearly every class of retail trade. The figures showed comparisons of sales during two periods of one week each. Each store selected some particular line for the test. This line was not displayed during the first week, but the second week the same goods were featured in a window display and a careful record of results was kept for both weeks. One drug store reported that sales increased on two displayed items 95 per cent in one case and 165 per cent in the other, during the period that the goods were featured in

the windows. In twenty-one grocery stores a gain in sales of 70.8 per cent was averaged. Retail stores usually pay rents in proportion to the number of potential customers who normally pass the location. This traffic may be increased by the newspaper and direct-mail advertising of the different institutions which attract people to the shopping center, but the question as to whether rents are low or high will depend to a large degree upon the relative number of people who are induced to enter the store, because of effective displays and convenient location of entrances.

The display of merchandise in department and specialty stores is a particularly strong factor, because of the state of mind in which consumers visit such retail establishments. In an investigation which was carried on in a Boston store it was found that out of 3,895 purchases, the merchandise had been seen advertised in only 14.1 per cent of the cases. Similar investigations in other stores lead to the conclusion that less than one-fourth of the merchandise purchased in retail stores is traceable directly to advertising. This is significant, in that it shows that the major portion of the business of the retail store is the result of influences other than newspaper and direct-mail advertising. At the present time, no general study has been made of the relative amount of merchandise which is purchased as a result of display and the amount which the customer deliberately goes in search of.

The pulling power of convenient display is shown to some degree by the relative amount of sales which are made from tables placed in aisles in which the traffic is heavy. In most stores, these tables are scheduled so that each department has an opportunity to get the advantage of their use. A quota is sometimes established for the tables located in different aisles. So long as a department meets the quota it may continue to use the table, but as soon as it falls below the required sales the table is given to another department. The use of the aisle table varies with the type of store in regard to layout and the class of trade to which it is catering. An aisle table not only brings the merchandise to the attention of the customers, but gives her an opportunity to handle it, thus adding to the sales possibility. The crowd which assembles around an aisle table appeals to the instinct of curiosity and so becomes cumulative in its drawing power. In one of the large

department stores of New York the sales from special tables on the main floor in 1923 were $3,500,000, or about 8 per cent of the total business of the store. In this store, 24.5 per cent

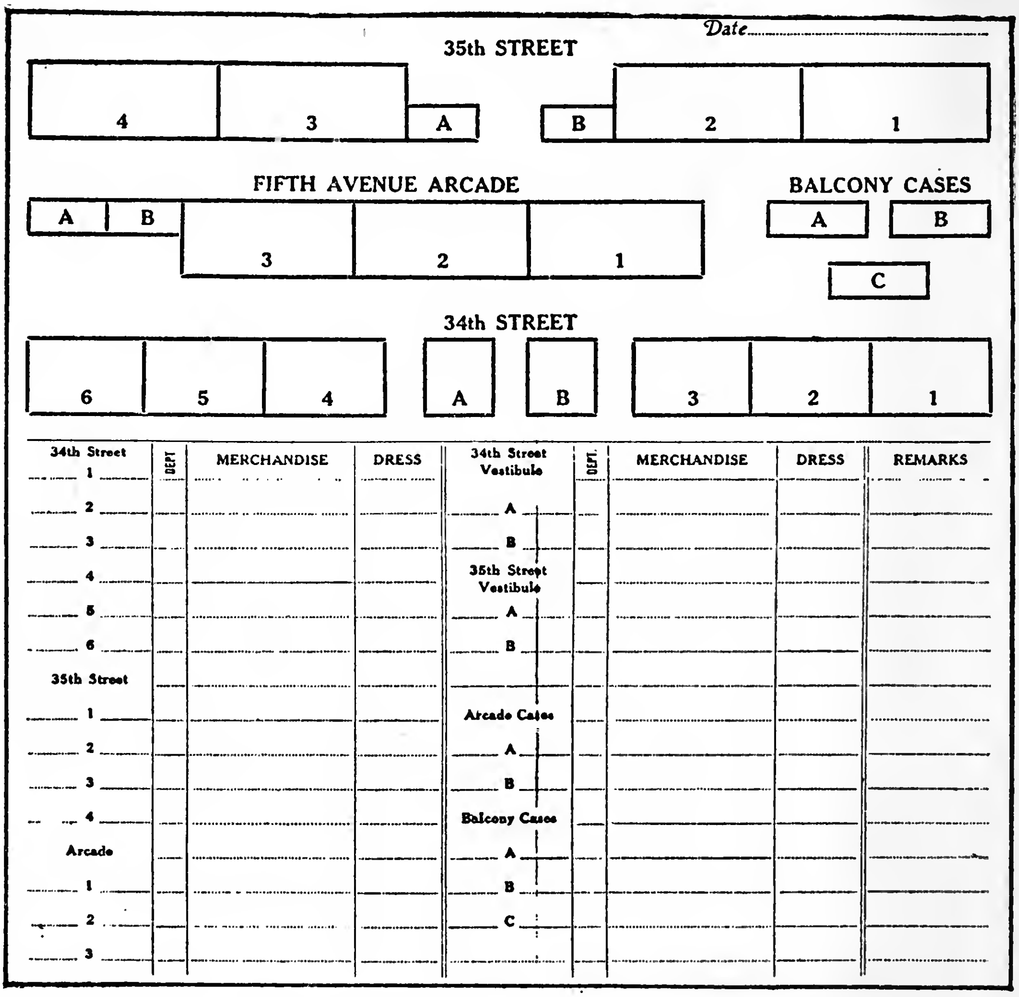


Fig. 42—Chart of Window-display Space.

of the total business was done in the regular departments of the main floor, although it has seven selling floors and a basement.

In order to coördinate display with the merchandise and advertising plans of the store, the window display space is apportioned to the different departments and lines of merchandise on the basis of a prearranged schedule as shown in Figure 42. The department manager must requisition space

to conform with his merchandise and advertising plans. For the purpose of record and control, it is necessary to charge to the display department the merchandise which is used for dis-

Window Display

Merchandise Record

NOTICE:—Make two copies. Give one to department and Display department keep one. Department retain one until merchandise is returned O. K. then give to Display Manager. Be sure to mark whether for display or accessory only.

Date In Window No.________ Display or Accessory ________

Quantity	Articles	Sell

Note to Trimmer:—Protect yourself, do not accept any soiled or damaged merchandise. Merchandise must be returned in as good condition as received.

Received from Department________the above.

____
Director Displays

Returned in good condition all the above

Received by________

Fig. 43—Window-display Record.

play purposes and to credit it when the merchandise is returned to the selling department. Figure 43 shows a convenient record of this type of control. In most stores each department is charged with window rental in direct proportion to the amount of space used. The policy is to give display space to all departments during the year, except those departments that carry merchandise which has little or no display value.

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Problems.

1. Through an error on the part of the advertising office of a large New York department store forty rugs were advertised for $1.97 instead of $197. A few weeks later the same store erroneously advertised 100 doll carriages at $2.44 instead of $5.48.

(*a*) What policy should this store have adopted in dealing with customers who insisted on buying the advertised merchandise in each of these cases?
(*b*) One customer stated that she had spent 50 cents carfare in coming to the store, and that she would take legal steps to force the store to sell her the merchandise or to refund her carfare. What are her rights?
(*c*) If an error is made by the newspaper and the merchandise is sold at the advertised price, is the paper legally bound to make good the loss?

2. The Hale department store is located in a large city in the East. It has an annual sales volume of approximately $20,000,000, and caters to a medium and high class of trade.

This store establishes a six-months advertising budget two months prior to the beginning of the period; that is to say, the budget beginning July will be established in May of the same year. This budget is based on 2.5 per cent of each month's sales of the preceding year for each department. This 2.5 per cent includes both direct and indirect advertising expenses. So far as possible, this amount is spread evenly among the departments. The 2.5 per cent is not likely to be reduced.

Special conditions may make it necessary temporarily to spend more than 2.5 per cent on a given department. Thus, the men's furnishings department is being moved to the tenth floor, which is quite an innova-

tion, and it may require 6 to 8 per cent in advertising to acquaint the buying public with this change. Pink tickets are used if there is a departure from the given percentage. Such "pink tickets" must be approved by the treasurer.

The lineage is not reduced when business momentarily drops. If any reductions are to be made they are made in the overhead. Multiplicity of sales is discouraged. There are perhaps eight sales a year of genuine authenticity. This store aims to have clean stock, marked right at its inception, and a complete assortment.

Each advertisement is not expected to pay for itself on the day of its appearance. What is aimed at is the total effect upon the month's, six-months', or year's business. In this direction institutional copy is used, which is not aimed to sell any given item of merchandise.

By the tenth of the preceding month the buyer sends to the advertising department an outline of what he would like to use in the way of lineage, and the day of appearance for the following month. The advertising department then coördinates the various requests so far as practicable and gives each department buyer as nearly what he requested as is possible. Such a tentative schedule is given to the buyer about the fifteenth of the preceding month. When the buyer is ready to use his allotted space, he sends the required information to the advertising department one week before the date of advertisement.

(*a*) Should this store plan to spend the same percentage of sales for advertising for each department?

(*b*) In some stores the policy is to increase the advertising expenditure during the dull periods and to decrease it during periods of high sales. In other words, to attempt to smooth out sales peaks. In other stores the policy is to take advantage of low-sales resistance by increasing the amount of advertising during the months of high sales and by decreasing the amount of advertising during the months of high-sales resistance, or low sales.

3. In explaining the disadvantages of store-wide sales, Mr. Beam, the sales promotion manager of the Marsh department store, made the following statement:

"Suppose we have a class of merchandise that is originally marked up to 40 per cent on selling price. How much additional business would be necessary to stand a mark-down of 10 per cent, of 20 per cent, of 25 per cent, on the original sales price? Suppose a garment is marked originally at $100 which cost $60, that leaves a margin of $40. Now, we decide to sell the same garment for $90. In order to make the same $40 margin, we must now sell $40 divided by the new gross margin of

$30, or one and one-third times the quantity of merchandise, or $120 worth at the new price. Suppose we want to sell the same garment for $80. In order to make the original $40 we must sell $40 divided by $20, the new gross margin, or twice as much of the original merchandise, or $160 worth at the new price. Now, we decide to sell the original garment for $75. How much more merchandise must we sell in order to make the original $40? Well, we will divide $40 by $15, the new gross margin, and we get two and two-third times the original quantity of merchandise. That means we must sell two and two-third times as much merchandise, or $200 worth at the new price."

Is Mr. Beam's statement correct?

Chapter XII

ADVERTISING POLICY

A policy is a definite principle or method of procedure, adopted and followed by the retail store in its relation with customers, employees, and people from whom it buys. In relation to customers, policies concern themselves with prices, the ways of selling goods, services rendered, quality of goods handled, the impressions created by advertising, and the manner in which adjustments are made. If a definite policy is followed, and it is in line with the best interests of the customer, there is built up a cumulative advertising effect. An outstanding example of the effect of a definite policy in relation to customers is that of a store in New York which has built a large portion of its institutional prestige upon "Merchandise of taste and quality at lowest-in-the-city prices," or a "6 per cent underselling policy." Several times in the history of this store the management has been called upon to decide between large temporary losses through competitive price reductions and an adherence to the policy of lowest prices. In each case the prices were cut or the lines discontinued. Each test of the policy has served to emphasize it in the minds of customers in such a way as to produce a cumulative advertising effect. In all cases brought to the attention of the store the prices are adjusted. Recognizing the importance of maintaining this policy, the store in a great number of cases has made refunds to former purchasers of the differences in price which were found to exist. Thus, the policies of a store serve to advertise it and to define its limitations. Successful retailing institutions have developed under definite and clearly defined policies.

The first essential in retail advertising is that the impressions which it creates should be in conformance with the general character and merchandising policies of the institution. The character of the store and the style of its advertising have

an intimate relationship and their effects are reciprocal. Primarily, the style and the policy of advertising reflects the character of the store, but the reverse process is always at work. The reputation and the prestige of the store—which is the public estimation of its character—are a direct reflection of its advertising as well as its merchandising policy. If the advertising has created an impression of dignity and refinement, the customer must get the same impression from her contact with salespeople, merchandise, and the service which the store renders. Similarly, any intelligent shopper who has been influenced to visit a store by huge letter type promising mammoth savings would hardly expect to find goods of sober worth and a general atmosphere of quietness and exclusiveness. It has been well established that a store cannot effectively cater to all types of customers in its merchandising policy; similarly, it cannot attract one class of trade by its advertising and give service and merchandise which appeals to an entirely different clientele. The character of a store and the style of its advertising must harmonize, if it is to get a maximum return from advertising expenditures.

The purpose of advertising, as already defined, is to influence the prospective customers and get a response through sales. On the basis of response desired, advertising may be divided into two classes. In the first class the dominant purpose is to induce a feeling of friendliness for the institution and general confidence in the type of merchandise which it handles. This class includes advertising variously designated as "institutional," "service," and "prestige," but goodwill advertising is probably the most general and acceptable term. In the second class the dominant purpose is to secure direct and immediate action on the part of customers. This is called direct-sales advertising to distinguish it from indirect, or goodwill, advertising. It may readily be seen that the two classifications are not mutually exclusive. In the first place all good advertising, whether institutional or direct sales, must be for the purpose of building goodwill and creating confidence. In most institutional advertising some direct returns are expected, though they may not be traceable to any particular item of merchandise.

Institutional or goodwill advertising.—This type of advertising aims to establish the reputation of the store as a high-

class institution. Its object is not so much to sell any specific article or class of merchandise as to sell the services and policies of the store and to build up its prestige by focusing attention on the institution itself. If a store can gain the confidence of those who read its advertising, it is not necessary to make a statement regarding the particular quality of each item of merchandise which is advertised. The mere fact that the store handles it gives the suggestion of a high type of merchandise.

Institutional advertising may be in the form of editorials like those signed by John Wanamaker; light, chatty talks on present tendencies in style; direct arguments for some individual store policy, such as deposit account, cash, or credit; anecdotes and bits of history; or essays giving information that is itself of service to the public. In the smaller cities and towns and, to some extent, in the larger ones, a merchant often projects his own personal characteristics into his advertising. Some of these advertising talks are so interesting and informative that people watch for them daily.

Direct sales advertising.—Most of the advertising of retail stores is done to promote immediate sales by bringing to the attention of the public specific items of merchandise. This type of advertising may be divided into two general classes: (1) that which emphasizes price; (2) that which emphasizes quality. The former may be designated as bargain advertising, in that it places the chief emphasis on price and tries to make this seem low in comparison with the value offered. Because of its powerful and immediate effect in drawing people inside the store, this is the staple variety of advertising and is used to some extent by practically all stores. The method of presenting the appeal depends on the store policy, but the basic elements are essentially the same. A good bargain appeal contains the price conspicuously displayed, a statement of the amount of saving, an exact description of merchandise, and a reason for the price. Although some of these facts may be implied instead of stated, usually an element of suggestion is used in the advertisement to increase its effectiveness.

The common practice is to compare the present price with the former or regular price, or to state the per cent of saving as "Price $8.95, Value $10"; "Was $20, Now $16.48";

"Prices cut in half"; or "Take 20 per cent off the price marked on the tag." As a general rule, the impression of reduction is further emphasized by using fractional prices. These are usually a little less than some round number to which the mind instinctively relates them, and this process of subtraction suggests a saving. Thus, 98¢, $2.95, $4.75, $18.75, and the like suggest savings when they are read or when cash customers receive their change at the time of purchase. The two specimens below are typical of the price appeal.

FRESH SHIPMENTS OF CHOICE PATTERNS—

$2 to $2.25 Shirts for	**$1.45**
3 to 3.50 Shirts for	**1.79**
4 Shirts for	**2.15**

$20 Bags 25 Bags 30 Bags 35 Bags 40 Bags	**$9.85**

The frames in these bags are hand-pieced filigree, of Trinity Plate and are alone worth double the price. Think of it!

Some merchants use the odd price to suggest that the goods have not been manufactured to meet a price, but rather to meet a certain standard of quality, and the price has been allowed to take care of itself. A price slightly above an even number is sometimes used with the idea of creating an impression of higher quality. A man who has been in the habit of paying $1 for a necktie or $5 for a pair of shoes may be favorably influenced by a price of $1.15 or $5.50. There is the suggestion that, by paying a little more than he is accustomed to pay, he will get better quality. Another reason for the use of odd prices is that it serves as a check on the salespeople, in that it necessitates the making of change in practically every transaction. This is especially true in stores in which the salesperson makes change and wraps her own package. The use of odd prices is directly dependent upon the appeal which the store wishes to make.

There is a common practice of stating the exact quantities which are offered for sale, as 2,178 suits, 642 overcoats, and 217 traveling bags. This helps to establish a belief that there is a concrete lot of merchandise to be sold. Furthermore, it stimulates action by suggesting that, as only a limited quantity is available, purchases must be made early. Such a statement also supplies a valid excuse for the disappointed customers who arrive too late.

In placing the emphasis on quality the aim is to focus the attention of the reader upon psychological values, such as up-to-dateness of style, exclusiveness of design, and similar intangibles, or upon material, workmanship, or actual service. Price is mentioned usually, though not always, with the expectation that it will appear low. To convey the impression that the merchandise offered has quality the advertiser must resort to illustration, description, and layout. It is in the description of merchandise that differences in store policy are most apparent. In some stores the tendency is to use generalities and superlatives, such as "matchless," "lowest prices ever quoted," "greatest assortment," and "unparalleled." Other stores are more conservative. They avoid all generalities and confine their descriptions to a concrete and accurate picture of colors, material and workmanship, rarely using a stronger adjective than "unusual" or the like.

Comparative price.—The policy of stores differs widely in the use of price comparison. Some stores feel that the influence of a price reduction is seriously lessened as an appeal to the average customer unless the original or usual, as well as the new, price is quoted. These stores assume that many customers are unable to judge quality and therefore fail to recognize the value which the store is offering them without a statement of the original price for comparison. The conclusions of another group of stores are summed up in the following newspaper [1] announcement:

"When comparisons in price represent the exact truth, we see nothing wrong in their use. But an intensive investigation covering many years has convinced us that the temptation to exaggerate alleged value is so great that protection of the customer demands the abolition of the comparative price.

[1] Copeland, Melvin T.: "Problems in Marketing," p. 73.

"For many years, we permitted the use of comparative prices, carefully censoring every such quotation before giving approval. But in spite of careful censoring, we found it impossible to avoid exaggeration. Therefore, about four years ago, we forbade the use of comparative prices.

"But there was also another reason for their elimination. We found that even when we did employ truthful comparative prices, our advertisements looked weak when placed alongside the exaggerated claims of reductions and special values of other houses. As we could not compete in lying, we were beaten from the field.

"We thought it better to follow the example of the little East Side storekeeper (now one of New York's leading merchants) who, when his shop was surrounded by other stores bearing grossly exaggerated signs, ran across the front of his store a large sign reading:

" 'Men's Suits'—'Real Value $20'—'Our Price $20.' "

The tendency at the present time is to eliminate unqualified comparative prices. Lord & Taylor of New York has entirely eliminated the use of comparative prices both in advertising and on the price ticket of merchandise which has been reduced. The policy of a store in regard to the nature of its appeal and the clientele to which it is catering is the determining factor in deciding whether comparative prices should be used. The logical conclusions would seem to be that comparative advertising is allowable when the comparisons are accurate and the values shown legitimate. From the point of view of local merchandising the misuse of comparative-price advertising and the abuse involved in comparative-value advertising call for unceasing attention. Few women shoppers really understand just what is involved in comparative prices and values, and therefore misleading impressions are easily conveyed. Such a statement as "Skirts $10, former price $25" may be true, but in a sense quite different from what the reader supposes. The skirt probably did sell for $25 a year ago, a little later for $20, and still later for $15, and now it is offered for $10. There would be no objection to mentioning former prices if the dates were mentioned. If the skirt sold for $25 only a few weeks ago instead of a year ago, and is now selling for $10, it is probably a good bargain. Because of the changing price levels due to changing styles,

the fact that it sold for $25 a year ago does not have any real bearing on its present value. In other words, it is a question whether the merchant is justified in using the prices at which articles sold six months or a year ago if there have been intervening reductions. In the case cited, if the advertisement had read, "Skirts $10, former price $15," it would have been truthful in the strictest sense.

The possibility of misstatements and deception are even greater when merchants compare values rather than prices. A fur dealer was convicted on the charge of advertising a $125 seal coat for $30, when the actual value was found to be precisely $30. In rendering its decision the court said that a coat with a valuation of $30 was never manufactured to retail at $125. Naturally, reputable merchants do not make such representations, and few cases that involve the use of comparative values are ever serious enough to take into court. But the evil is none the less great. When a merchant advertises "Suits $35, $50 values," what does he mean? The suit may have had a value of $50 six months or a year ago, and may be wholly out of style today. Is it fair, then, to say that the article has a value of $50 now?

Many of the better-business bureaus have attempted to enforce a rule that comparative values in advertising should be based on the price at which the same article is being sold in three or more other stores in the same city at the same time. They take the position that a representation of value or worth which is other than the current value is deceptive. If, in the case cited above, it is found that three or four other stores in the same city are selling the same suit for about $35, then the position is taken that by no stretch of imagination can it be described as a $50 value. Of course, if the merchant had said, "Suits $35, were considered to be worth $50 last spring when this model, which is now out of style, was all the rage," there could be no possible objection. Many merchants feel that comparisons are necessary to stimulate business; but, on the other hand, the store which advertises that a suit which is selling at $35 today was priced or value at $50 six months or a year ago is more likely to be suspected of having profiteered in the first place than the one which avoids such comparison.

Standards of practice.-Although there is a predominance of exaggerated statements in retail advertising, the tendency is toward strict accuracy and the elimination of superlatives and statements capable of misinterpretation. Truthfulness in advertising has always been recognized as the best policy by far-sighted merchants. The cycle of keen competition, however, developed an exaggeration of statement on the part of the less scrupulous advertiser, the initial effect of which was to draw customers from the more conservative merchant. For the dishonest and short-sighted merchant this type of advertising presented an opportunity; for the far-sighted merchant it presented a responsibility.

When customers respond to sweeping superlatives and glittering descriptions and find the merchandise not up to their expectations, they begin to doubt the statements which are made by advertisers in general. The result is a general decrease in the drawing power of advertising. Leading advertising men of the country have formed associations for the purpose of studying advertising practices and evolving methods to conserve the strength of advertising appeal. The following well-defined standards of practice were formulated by the Sales Promotion Division of the National Retail Dry Goods Association:

Standards of practice for retail advertising.—As retail advertising men, it devolves upon us to conserve and advance the reputation of retail business, and of the institutions we represent. Recognizing that our duty to the public, as well as the best interests of retailing, call for honesty, sincerity, and candor in advertising, we have formulated these Standards of Practice to govern the profession.

Advertising is socially useful, because it enables the consumer to buy more intelligently and with less effort. We have thought of advertising as commercially useful in performing a twofold function:

(*a*) To sell the merchandise advertised.
(*b*) To "sell" the institution advertising.

We should think of it as performing a third function also:

(*c*) "Selling" advertising itself.

As advertising men we should be as jealous of the reputation of our profession as the wise merchant is jealous of the reputation of his establishment.

1. Advertising should not only be truthful, but should at all times avoid even the semblance of untruth, or the suspicion of insincerity. Understate rather than overstate. To this end:

(*a*) Avoid "superlatives" such as the "greatest sale," "the biggest stocks," "never before," etc. Not only is it unsafe to make such statements without qualification, but the public is inclined to discount their accuracy.

(*b*) Be as careful about the implications of your statements as about their direct meaning. Avoid ambiguous phrases and statements capable of misinterpretation.

(*c*) It is often wise to moderate even true statements when they are so startling as to appear incredible.

2. In advertising "sales" or "special prices" the language used should be so plain as readily and unmistakably to convey the actual facts in the case. We believe that carelessness and misunderstanding of terms is responsible for at least as many inaccuracies in advertising as dishonest intent. We recommend, therefore, the standardization of terms used in describing reduced or "special" prices to minimize the possibilities of error and disagreement. We offer the following partial list of definitions:

(*a*) The term "formerly" or "reduced from" should be understood to mean that the article has just been reduced in price. It is equivalent to the phrase, "Yesterday's price was."

(*b*) Where several successive reductions have taken place, if the term originally is used, the previous price should also be given.

(*c*) Such expressions as "worth," "value," "grade" should not be used. If we are to assume that advertising is read by the public, then the lowest advertised price of an article fixes its current retail "value."

(*d*) The terms "regularly" or "usually," when used in connection with a new purchase, should be understood to mean the price at which the article was on sale in the same store immediately prior to the special offer.

3. Where specific quantities of merchandise offered in a sale are mentioned, they should be accurate. "Million Dollar

Sale" should mean that merchandise totaling a million dollars at reduced retail prices is offered at special prices. The quantity mentioned should be in the store, in its own warehouse, or in its own possession, and immediately procurable, when the sale opens.

4. Descriptions of merchandise should be as complete as necessary to enable the reader to determine the true nature, materials, content, style, workmanship, sizes, colors, and designs of the article advertised. For example:

(*a*) Textile fabrics should be plainly identified as wool, cotton, linen, silk or "gloss."

(*b*) If two or more yarns are mixed in a single weave this should be plainly stated, as silk-and-cotton; wool-and-silk; linen-and-cotton, etc.

(*c*) Commonly accepted trade names for furs, applied to pelts finished to resemble the genuine, should be used with descriptive definitions, for example, Hudson Seal (dyed muskrat), French Seal (dyed coney or dyed rabbit).

(*d*) Trade names, such as satin de chine, or velveteen, sateen, etc., should be modified by such explanatory notes as "part cotton" or "cotton."

(*e*) If an article of furniture is described as mahogany or walnut, it should be either solid mahogany, or walnut, or veneer, not merely stained to resemble the genuine. If other woods are used in the piece, the phrase "combination mahogany" or "combination walnut" should be used.

(*f*) Whenever gold is mentioned, specify the carat content.

5. "Seconds," "irregulars," "imperfect," or "soiled" goods should be plainly stated as such, in conspicuous type.

6. When a headline at the top of a page, or of a smaller composite section of advertising, leads the reader to believe that all items mentioned under it are included in a general sale, every item on the page or in such section should be specially priced.

7. Avoid the use of illustrations which are misleading regarding size, quality, or appearance of merchandise advertised, or which exaggerate the size and importance of a store's building or buying facilities in other cities. In mentioning buying offices in other cities they should be designated as such, and thus avoid the impression that they are stores.

8. We recommend that, in each community, the retail advertisers effect or support an organization whose function it shall be to scrutinize advertising carefully, check it against actual offerings and bring inaccuracies to the advertiser's attention.

Better business commissions.—At the instigation of the National Vigilance Committee there have been established during the last few years organizations known as Better Business Bureaus or Commissions. These commissions have three main objects: (1) to increase public confidence in advertising and in business, and to educate the public to an understanding of the integrity of purpose and practice of honest business; (2) to prevent deception in advertising and merchandising and to correct wrong practices; and (3) to reduce unfair competition and thereby help to keep selling efforts in constructive rather than destructive business channels. These commissions have been established in most of the larger cities (in 1925 there were 44) and are usually derived from all types of business concerns in the community. They can do the work more effectively than it can be carried out by other means. It is neither easy nor effective for one merchant to call upon his competitors and tell him that his practices are dishonest or unethical. Such a complaint would be received with the feeling that the complainant was making it out of selfish motives and from a biased point of view.

There are three separate methods employed by the commission to bring about honesty of statement: (1) suggestion; (2) publicity; and (3) prosecution. The last is rarely resorted to. Out of 2,500 cases handled in one city, only 8 required prosecution. The operation of the commission is usually as follows: Any one may submit a complaint, or the bureau itself may be active in locating cases of objectionable practices. In either case the source of the complaint is always confidential. The commission then checks upon the correction of the claim by sending an investigator to the store against which the complaint is brought, or by sending a letter to the firm calling attention to the nature of the complaint and asking for a statement to indicate whether there is a legitimate explanation for the practice. In most instances undesirable practices are eliminated or corrected by this method.

In some of the larger cities there have been organized merchandising or retail divisions of the Better Business Commission. The function and scope of an organization of this kind are about the same as that of the Better Business Commission outlined above. It operates by scrutinizing daily the store advertisements and by sending shoppers to purchase merchandise regarding which there is doubt. A report is then sent to the store indicating whether the suspicion was confirmed or shown to be unfounded. If an objectionable practice is discovered it is taken up with the merchant with the usual result that it is corrected.

Use of illustrations.—The major function of advertising is to create, in the minds of people, mental images of the merchandise which can be purchased in the store. There is a consensus of opinion among retail advertisers that illustrations facilitate the creating of these images and for this reason cuts are used by the majority of stores. The value of illustrations has increased rapidly with the growth of such counter attractions as electric signs, moving pictures, magazines, and radio. These mediums not only present counter attractions, but occupy a larger portion of the reader's time, so that less time may be given to the reading of advertisements. In the second place, the psychological attitude of the reader of the newspaper is the news attitude. There is competition, therefore, between the news headlines and advertisements. It becomes necessary for the advertiser to get the impression over more quickly as this competition increases. In an analysis made of 345 letters sent to the *Chicago American* by its readers in an advertising contest, the reasons for the domination of a particular Marshall Field & Company advertisement were as follows:

	Per Cent
Illustration	22
Appeal to saving	21
General appearance	15
Impression of reliability	14
Authoritative style	12
Timeliness	7

If the illustration is to be an effective aid to advertising, it should not only attract attention and create a mental image, but this mental image should be of the merchandise which

the customer will actually see when she visits the store. The cuts, therefore, should be exact reproductions of the merchandise on sale. If a store is large enough to warrant having artists on its staff, these cuts should be made up from drawings of the merchandise in stock. Smaller stores rely upon the manufacturer or an agency to furnish them with cuts.

A second advantage in the use of cuts is that they add to the attractiveness of the advertising. This is especially true in stores that feature a distinctive type of advertising. Sometimes, this distinctiveness is achieved by the use of silhouettes to illustrate the cut of a gown, by a distinctive border, or by a peculiar layout with special type that attracts the eye and makes the advertisement easily recognized, even before the name is seen.

Use of space.—In the use of space the policy of stores differs as to whether the advertisement should be used in one block or split up and used in several units scattered throughout the paper. The policy which has come more and more into vogue in the larger stores within the past few years is to split up the newspaper space, advertising each line of merchandise as a unit. In this manner the reader's attention may be caught not once but several times as he glances through the paper. Other stores, however, still hold to the older policy of using a single unit. There are obvious advantages in both methods. In favor of the use of space in one unit, a small retailer is able to give an impression of size and dominance to a particular line, which he cannot give by splitting up his space into a number of relatively small units. Furthermore, the single unit saves the space otherwise needed to repeat the signature or name of the institution, the border, and sufficient amount of white space to make the copy stand out. On the other hand, the splitting up of the space into smaller units, particularly in the case of a large retailer who uses a considerable amount of space, makes it possible to group together in one place, as a unit, items which are naturally associated. This avoids the miscellaneous compilation of a great variety of irrelevant and miscellaneous articles. The purchaser may be interested in men's wear only. By splitting up the advertising space, these articles may be located near the sporting section and thus increase

the possibility of their being read. As a general thing, it is good policy to split up the space by means of border or white spaces, whether the advertisement appears as a unit or in different positions in the paper.

Timely advertising.—One point in which retail advertising is somewhat different from other types of advertising is the utilization of the news element. All interests of the human mind are either innate or acquired. The innate interests are the fundamental instincts. Acquired interests are the result of experience. They are divided into two general classes: permanent and temporary. Nearly everyone has a permanent acquired interest in a political party, a fraternal organization, or a sport. On the other hand, there is a temporary interest in a particular presidential election or football game with which the advertiser can associate the news of the day.

The alert advertising man is quick to realize that in the news and events of the day he has powerful allies which greatly strengthen the advertising appeal. The effectiveness of such copy was recently illustrated in the case of a store in New York, when copy based on the attempted robbery of the store appeared simultaneously with the news stories of the robbery, the ad telling the story in a more enlightening fashion.

Special sales.—In order to stimulate the normal demand for merchandise, retail stores have developed periodic sales events in which merchandise is advertised to the public at lower than the regular or normal retail price. These special sales events originated in the retail store as a means of clearing out end-of-season stock, such as remnants, odd sizes, discontinued lines, and slow-moving items. Scientific merchandising, however, is attempting to reduce the necessity for this type of sale to a minimum by a more careful planning of stocks and purchases in accordance with the normal demand of the community. Many stores have attempted to offset this reduction in price of the left-overs, or poorly purchased article, by fair margin of profit on goods that are specially bought to serve as fillers. Thus, the original clearance of odds and ends developed into a special purchase sale, due to the fact that the end-of-season clearance offered to the public a legitimate reason to expect merchandise at a bargain.

Classification of sales events.—Sales events may be divided into three major classifications according to the conditions

from which they arise. The first of these may be called the season condition, meaning the demand for goods that is brought about by the calendar seasons, such as spring, winter, summer, and fall. The second is the condition of stock in the store, such as slow-moving lines, end-of-season stock, special purchases, or a general overstock due to adverse weather or a break in the market. The third classification which gives rise to sales events is a change in store conditions, such as remodeling, removing, expansion, new departments, or reorganization. It is generally recognized that the public must be given a plausible reason for the reduced price or sales event. The rapid change of style from one season to another offers an effective advertising appeal in all lines of seasonal merchandise. The pre-season and post-season sales, therefore, are perhaps the most common events in the retail store. Furs and overcoats are offered in July and August at greatly reduced prices to smooth out the sales peaks, to create interest in fall clothes, and to sample the tendencies in style. Stores hope to break down sales resistance at this time of year by a substantial reduction in prices.

There is a diversity of opinion regarding the general policy of featuring any type of out-of-season merchandise. Although there are instances—such as coca cola—where by persistent advertising the seasonal peaks in the sales of a product have been very greatly eliminated, this general policy does not seem to apply to retail merchandising. In the more staple products, in which the style element is of minor importance, production costs may be decreased by lengthening the manufacturing period, thus making it possible to pass on to consumers this margin of saving. In wearing apparel, however, the demand cannot be anticipated with a sufficient degree of accuracy to produce far in advance and thus to decrease the production costs. Although the demand for out-of-season merchandise is elastic to a certain degree, the cost of breaking down sales resistance by advertising and reduced prices is usually greater than the savings either to the manufacturer or to the retail store. Furthermore, if by out-of-season sales stores are able to sell any considerable amount of merchandise, the normal in-season business must necessarily be decreased to a certain degree. Within a given community it is not possible to sell any considerable amount

of merchandise at deliberately low prices and then sell the normal amount at regular prices. Although the general consensus of opinion among retail merchants is that this type of sale is not economically justified, a great many stores continue to feature it in order not to be out-done by their competitors.

The condition of stock as a cause of sales events is usually the result of change of season in the different lines. The retail value of stock at any particular time is directly dependent upon the replacement cost. Thus, the manufacturers' clearance sales at the end of a season have a direct influence upon the sales events of the retail store and have resulted in a somewhat uniform schedule of sales events throughout a community. Such events are the clearance sales of whole industries, which cannot be regulated by any particular retail store or group of stores.

In addition to these sales events which are brought about by change of season and consequent condition of stock, there has developed a general observance of special store occasions, such as anniversary sales, founder's-day sales, and the like. Other special occasions brought about by store conditions which give rise to sales events are removal, remodeling, and alteration sales. All of these sales or events get their names from a store condition not directly connected with a special season. Most of the special sales events which are found in retail stores have developed on the theory that the public are willing to buy merchandise at an advertised price if a good reason for the sale is given. Inasmuch as only a certain number of real reasons for sales actually exist, it is necessary to devise a seemingly logical reason for offering merchandise at a price considerably below normal. Consequently, a great many stores have taken advantage of public confidence by offering reasons for special events which are not based upon actual conditions. The immediate effect of this type of merchandising is to detract the flow of goods from their normal channels and thus to decrease competitors' legitimate profits on particular lines.

As a general rule, manufacturers readily coöperate with the retailer in special sales by granting lower prices because of quantity purchases. Thus, two factors contribute to make a special sale profitable to the retailer. The first is lower

costs for the merchandise, and the second, increased business, which enables him to offer slightly lower prices to the public and still maintain higher profits. If a good reason for the sale is given, the normal mark-up percentage may be maintained by simply passing on to the customer the reduction in price which the retailer is given by the manufacturer. From the individual merchant's point of view sales events may prove profitable both in stimulating immediate sales and in increasing the store's clientele.

Effect of special sales.—If these special sales events are used by all stores in a community the ultimate result is that the consumer purchases a large portion of his merchandise at a price which is lower than the normal cost of distribution. This lower price must necessarily be compensated by charging a higher price on other lines of merchandise. It might be argued that if a store is able, through a large volume of sales, to sell merchandise at a price lower than normal the customer is benefiting by that amount. This is true so long as only one store is considered. If, however, the entire community is considered, it can readily be seen that the gains through sales events of one store are counter-balanced, to a large degree, by the losses of other stores. For instance, if there are three stores equipped to take care of the normal demand for men's suits, and one store in a special sales event sells a considerable portion of the year's supply, it is evident that the sales for the remainder of the year will be materially decreased in all the stores. This, naturally, will result in a higher percentage of operating cost for the department. Some merchants point to the idea that the increased volume, even if obtained at a loss, helps to reduce the percentage of operating cost over the year, and thus makes possible a large margin of profit at the end of the year. Working under this principle some merchants feel justified in giving a certain amount of free merchandise in order to stimulate trade. Still another group features standard advertised brands of merchandise at prices far below the normal mark-up, in order to attract trade and create an impression of general lower prices. In most cases every decrease in normal price must be counterbalanced by an increased price in another line, in order that the law of averages may properly function. This does not necessarily mean that one store in a community cannot con-

sistently offer lower prices by the continuous use of special sales events. There are outstanding examples, especially in metropolitan areas, where stores have been able, over a period of years, to maintain an increasing large volume of sales by continued use of selling events, and at the same time to maintain a low average percentage of mark-up. This may be accounted for, however, by the fact that the potential sales for a metropolitan area are practically unlimited and the saturation point less quickly reached.

As a general rule special purchase sales disrupt the normal functioning of the retail organization, resulting in an intangible loss due to poor service. The presence of new employees in a department, whether new to the organization or transferred from other departments, materially decreases the efficiency and morale of an organization. Still another factor to be considered in special sales events is the effect of exaggeration and misleading statements that such pressure merchandising depends upon. How can a merchant offer new goods at 50 per cent and more off their original or regular price and still expect customers to have confidence in his regular prices? If these statements are believed, the customers may purchase readily at the sales event, but will be suspicious of the regular merchandise. Another disadvantage in building any considerable portion of the total volume upon sales events is that the whole merchandising plan of the store is built upon an artificial sales plan rather than around the needs of normal business. What is recognized as last year's overbuy is included in this year's plans, so that the special sales events are cumulative in their effect upon the normal plans of a department.

Recognizing the disadvantage accruing to the misuse of special sales, some stores have publicly announced that they would hold no more sales, but would offer merchandise throughout the year at prices as low as possible consistent with cost of operation and normal net profit. Such a policy has met with reasonable success. It is generally recognized that the continued use of sporadic special sales events by competitive stores results in a general loss to all.

Direct-mail publicity.—In order to supplement the general advertising and appeal more strongly to a particular class of people, most of the larger stores mail merchandise and store

information directly to a selected group of people. This information may be in the form of personal or form letters, catalogues, booklets, house organs, or simply current announcements of merchandise or store news. The first essential in direct-mail publicity, as in newspaper advertising, is that the mailing list include only customers of the particular class to which the store is catering. The second essential is that the general style and form of advertisement must conform to the type of merchandise and service which the store is offering. Finally, the advertising must be seasonal and must induce people not only to buy, but to come into the store. The same general principles, therefore, apply to direct-mail advertising as to newspaper advertising.

Most stores have found it advisable to make the nucleus of the mailing list the store's own customers, taken from the files of the credit department, rather than to purchase from agencies or to compile a list from directories or other sources. This policy, however, will depend upon whether the store or department is new or well established. The direct-mail department should be placed under the direct supervision of the advertising department, so that its general style and activities may be coördinated with other forms of publicity. Envelope inclosures mailed with monthly statements or with personal letters to clients are without doubt the most economic media of printed salesmanship, because there is no expense for distribution and they reach a particular clientele with practically no waste circulation. Some stores make effective use of direct-mail advertising by encouraging salespeople in certain departments to write personal letters to customers concerning merchandise offerings.

The primary function of direct-mail advertising should be to encourage customers to come into the store rather than to shop by mail. This is especially true in department and specialty stores, where the customer has an opportunity to purchase much more than the advertised article. The particular advantage of direct-mail advertising is that merchandise may be offered to customers without informing competitors at the same time. It is generally used to inform credit customers of special sales two or three days in advance of the newspaper announcement. This helps to decrease the

sales peaks and also adds to the goodwill of the store's regular clientele.

Although direct-mail advertising makes an appeal to a selected class of people, there is a limit to its use as an effective advertising medium for the retail store. As in the case of the house-to-house salesman, an increase in the use of this medium tends to decrease the interest in all forms of letters which have the semblance of offering something for sale. To overcome this objection some stores use a subterfuge by having plain hand-addressed envelopes. Unless the contents actually offer some extraordinary service or merchandise information, there results a feeling of resentment on the part of the customers. One of the major advantages of this type of advertising is that it does not suffer from the competition of other advertising. However, with the increased use of this medium by questionable institutions, such as stock-selling schemes, there is developed a cheap association which very greatly decreases the sales possibility of direct-mail advertising. Its most effective use will undoubtedly be to keep the store's own customers informed regarding store events and special merchandise features.

Mail-order sales.—A clear distinction should be made between advertising which aims to induce the customer to order merchandise by mail and that which aims to get her to come into the store to shop. Several metropolitan stores have developed mail-order services for out-of-town customers and, in a few instances, the larger stores have aggressively sought such patronage by emphasizing in the newspaper advertising the mail-order service and by mailing a catalogue to a list of customers. The general principles of a mail-order business are sharply at variance with those which have proved profitable in department stores. Wherever the volume of mail-order sales in a retail store becomes large and a catalogue has been issued, it usually becomes necessary to organize a separate department to conduct the mail-order business. After a mail-order catalogue has been sent out a stock of the merchandise advertised should be carried for a period of at least three months, whereas, in over-the-counter sales, a department store aims to have merchandise of the latest styles and to move the major portion of its stocks within a very few weeks. To minimize inventory losses through style depreciation, it re-

duces prices for clearance sales. Inasmuch as a more frequent printing of large catalogues is not economical, the same policy cannot be followed successfully for goods advertised in the catalogue. In order to meet this problem, therefore, separate stocks and separate merchandise policies usually become necessary, when a department store undertakes to carry on a large mail-order business through the use of catalogues.

If a mail-order business is encouraged in staple lines the public naturally tends to associate the store activities with those of the larger mail-order houses, and make price comparisons as a natural consequence. As a general rule, a department store cannot compete favorably with a highly developed mail organization, because of its smaller purchasing power in individual lines. Unless a store caters to an entirely separate clientele in its mail-order business, it will be necessary to keep the catalogue prices and the prices advertised in newspapers on a parity. The policy which has been found most successful is to maintain an incidental mail-order service by sending circulars and special announcement of seasonable merchandise to out-of-town customers, or by advertising the mail-order service in newspapers, with the understanding that prompt action is necessary in order to be able to purchase the merchandise offered.

In analyzing the experience of stores who have sold merchandise successfully by direct mail, it is found that these stores did not offer goods calculated to lessen the attendance of customers at the store. The mail-order service should be offered as a convenience to those who either have little time to shop or to people too far removed from the store. All merchandise ordered by mail must be delivered either by the store's own delivery equipment or by common carrier. Furthermore, the sales per customer are decreased, because she buys from what she sees advertised rather than from shopping in the store. A mail-order business which does not encourage people ultimately to visit the store is usually not good policy.

Telephone sales.—There is a diversity of opinion regarding the policy of encouraging telephone orders. In some stores the current advertisement emphasizes the convenience of ordering by telephone. These stores offer special telephone service before and after regular store hours for customers to

take advantage of special items. A large department store in New York City especially emphasizes the use of the telephone by suburban customers. This store has leased a trunk line to several suburban centers so that customers calling the store pay only the local rate. Although the average transaction for over-the-counter sales is approximately $1.40, the average telephone order is between $3 and $4. The advertisements of this store usually contain a large variety of merchandise, conveniently itemized, to facilitate ordering by telephone. In promoting special sales some stores emphasize in their advertisements the use of the telephone in ordering merchandise. In some cases telephone orders are taken after store hours the day before a special event. One store located in a large metropolitan area took telephone orders for approximately 12,000 house dresses in one sales event, which lasted only one day. An opposite policy is that of another store in the same city which makes no reference in its advertisements to the telephone service. Although this store accepts orders by telephone it does so only at the request of customers and for the customers' convenience and not as a direct method of promoting sales.

Unless the average telephone order is large, there is no direct profit on sales made in this way. In the first place 100 per cent of merchandise ordered by telephone must be delivered, whereas, if the customer visits the store, she not only carries part of the merchandise purchased, but buys more because she comes in contact with it. Another disadvantage of telephone orders is that the merchandise is more likely to be returned, because the customer has not made so careful a selection of size, color, and style as when visiting the store. On the other hand, it is held by some stores that the sales expense of telephone orders is decreased sufficiently to counterbalance the increased delivery expense. Actual experience has shown that the cost of taking orders over the telephone is about the same as on the selling floor. Unless special arrangements have been made with the telephone company for extra switchboard service during special sales events, the lines become overtaxed, resulting in a general loss of efficiency and in the loss of goodwill on the part of the store's clientele.

The department store is primarily a shopping institution

and its chief advantage lies in the facilities it offers to customers to purchase a wide range of merchandise under one roof. Because of its wide range of merchandise it is able to suffer losses in some lines so long as these items contribute to the sale of other goods which bring a profit. Telephone sales are primarily for sales promotion, and, as in the case of mail orders, unless the telephone orders contribute to the sale of other merchandise it is usually good policy to offer this service only as a convenience to those who cannot come to the store rather than to encourage customers to use it.

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Problems.

1. The Melville department store is located in the center of a large metropolitan area in the East. This store does a cash business only and each sale averages approximately $1.40. At the present time it has leased trunk telephone lines to several suburban centers so that customers may call the store by paying only the local rates. There has recently been submitted to the management of the Melville store a plan whereby the trunk lines would be discontinued and the customer would call the store direct, paying the telephone charges, and the store would then deduct these charges, up to 10 per cent of the amount of the merchandise ordered. Thus if the telephone charge on a call is 20 cents and the amount ordered is $3, the store will deduct the full 20 cents and charge the customer only $2.80 for the merchandise. If the telephone charge is 30 cents and the customer's order is $2, only 10 per cent, or 20 cents, will be deducted.

Should the Melville store adopt the suggested plan?

2. The Weldon department store is located in a town of approximately 200,000 population. This store has annual sales of $2,500,000. During the years 1923 and 1924 several instances were brought to the attention of the management of questionable statements made in the advertisements of the store. In two instances, Mr. Weldon, the general manager, was notified by the Better Business Bureau of statements made regarding blankets which were advertised as "all virgin wool." On investigation it was found that the blankets were not all wool. In defense of his position the advertising manager showed the original description of the goods as written by the buyer and the proof bearing the buyer's initials. The advertising manager contended that he could be held responsible only for the proper presentation of merchandise information, and that he was not qualified to pass upon the veracity of statements regarding technical qualities or contents of merchandise. Inasmuch as the advertising manager was a member of the local advertising club, he was anxious that the advertisements be free from inaccurate statements and misrepresentations.

In order to protect himself and the reputation of the store he submitted to the executive council of the store a recommendation that, where it was evident that a buyer had knowingly misrepresented his merchandise, he should be discharged from the store's employ. Mr. Black, the general merchandise manager, recommended that for each offense the buyer's department be fined $500 unless the case was one which clearly merited discharge.

(*a*) Should either of these recommendations be adopted by the executive council?

(*b*) Who should be made responsible for the accuracy of statements made in the advertisements of this store?

(*c*) What system should be used to insure that the responsibility be properly allocated?

3. In a city of approximately 275,000, located in the Middle West, the merchants have attempted to standardize sales by means of written agreements, entered into by the heads of the different retail organizations. In describing the method used, one member of the Merchants Association made the following comment:

"By these agreements we fix the opening dates of certain standard sales, and to a small extent regulate the wording of advertisements prior to and including these sales. Most of our merchants believe, in theory, in the elimination of some of the sales considered as institutions. There has been talk of eliminating January white sales and August fur sales. Yet no one merchant dares to eliminate any of these sales unless the others do likewise.

"Better business bureaus can do much to eliminate extravagant claims in advertising.

"No one wants the sale eliminated entirely. Such a plan would be folly, because the ordinary sale is entirely legitimate and has its basis on a sound economic foundation. Every merchant has leftover stocks which he may sell at low prices at the end of the season. This is entirely logical, and the consumer understands the reasons for it. Because an article is sold at a lower price at the end of the season than at the beginning is no reason why the consumer should lose confidence in the retailer. But when things reach a point where the store buys cheap stocks expressly for such a clearance, the real evil commences.

"Only to a small extent can sales be regulated by agreement. Various stores appeal to various markets, which is right and logical. One store makes its appeal almost wholly on the basis of price, which is perfectly legitimate. With another, price is secondary. A third store specializes in the buying of bankrupt stocks. This store cannot be held to seasonal sales such as the others, because its sales must be held when bankrupt stocks are bought. This store will make price claims that sound wildly extravagant, yet investigation proves them absolutely true. Yet no one will say this store's business is not legitimate. You can't apply the same yardstick of comparative prices to the store dealing in bankrupt stocks that you can to the store where price is secondary. I think the ultimate consumer realizes this. Because the store dealing in bankrupt stocks advertises shoes at $2, he doesn't believe the store handling high-class shoes at $12 is profiteering."

(*a*) Would the agreement of merchants to regulate sales events be a violation of the Clayton Act as tending toward a monopoly?

(*b*) To what extent may the customers be expected to profit by this plan?

(*c*) Does this plan have characteristics which should cause it to be generally adopted in other cities?

4. The McKernan department store in New York City has annual sales of $15,000,000. This store belongs to an association of seven similar stores, most of which are located within the metropolitan area of New York. This association holds semi-annual meetings at which the problems of department-store operation are discussed. Prior to the meeting in May, 1924, Mr. Hale, the merchandise manager of the McKernan department store, was asked to be prepared to conduct a round table on "The selling of branded merchandise." In preparation for the discussion Mr. Hale listed the following questions:

a. Should one brand name be attached to a number of different types of merchandise carried in different departments?

b. Should brand names be attached to different qualities of the same merchandise; that is, should we have different prices of hosiery, but sold under the same brand name?

c. How should new brand names be selected?

d. Should the store name be used as part of the brand name?

e. What are the advantages of a brand name that does not include the store name?

f. Should the purchase of one brand of merchandise be confined to one manufacturer, or should several sources be used at one time?

g. Should manufacturers be changed from time to time, or should an attempt be made to confine purchases to one indefinitely, so long as service, quality, and prices remain satisfactory?

h. What guarantee should be given, or what standard of quality should be maintained on branded merchandise?

i. Should branded articles adhere strictly to a regular price, or should we follow a policy of a lowered introductory price to gain attention quickly, and a semiannual sale at a lowered price, in order to secure wider distribution in a shorter space of time?

j. What types of merchandise do you consider most suitable for branding?

k. Should all branded names be copyrighted?

The McKernan store is located in the center of the shopping district and caters to a medium and higher class of trade.

What answer should the McKernan department store make to each of the questions raised bv Mr. Hale?

Chapter XIII

MERCHANDISING POLICIES

Most stores have found it advisable clearly to define in their price and service policies the class of trade to which they are catering. As a general rule, these classes of trade are best identified by the price ranges within which they buy, as high-priced, medium-priced, or low-priced. There can be no clearly defined lines drawn around the clientele of a particular store, because of the overlapping of the different price lines; however, a comparative study of the sales records of stores shows that there are at least three clearly defined groups of prices. Although these prices exist in most of the items sold, they are most noticeable in merchandise which is bought to enhance the personal appearance or social position of individual customers. For all classes of trade there exists what may be called high-priced or expensive merchandise, medium-priced merchandise, and low-priced or inexpensive merchandise. The measure in terms of dollars and cents of each of these price lines is directly dependent upon the individual customer as affected by her social or economic status.

Price Policy.

Table 27 shows the price lines in women's dresses in three competitive stores. It may readily be seen that the lower-priced dresses in the first store are about in line with the medium-priced dresses in the second store. Likewise, the low-priced dresses in store number two are in line with the medium-priced dresses in the third store. Each of these stores caters to one of three classes of trade and offers to this class an opportunity to purchase high- medium- and low-priced merchandise. It might seem that a fourth store offering all the prices in Table 27 could cater to a larger clientele than any one of the three stores, and, consequently, increase

TABLE 27

PRICE LINES IN WOMEN'S DRESSES IN THREE STORES

$10.00	$25.00	$45.00
12.50	29.50	50.00
15.00	35.00	65.00
17.50	39.50	85.00
20.00	49.00	100.00
24.50	59.00	125.00
29.50	69.00	150.00
34.50	79.00	175.00
39.50	89.00	200.00
49.50	98.00	
59.50	110.00	

its sales volume. There are two factors, however, which contribute to make such a policy impracticable. In the first place, a store must create an impression of distinctiveness, in order to attract the higher class of trade. It should be decorated and furnished so as to produce this atmosphere, and the merchandise carried should be priced higher than competitive stores, in order to attract well-to-do people. Such an atmosphere will deter people of slender means from entering. Moreover, the higher class of customers will not trade regularly in stores which do the bulk of their business at low prices. Thus, in a store catering to all classes, certain forces are working against each other. An atmosphere calculated to attract the higher-class trade will tend to keep away the lower-class and, conversely, the impression of medium- and low-priced merchandise will keep away the higher class of trade. A second disadvantage in catering to all classes by carrying a wide range of prices is the heavy stock which is required to maintain complete price lines and the consequent risk due to style changes. A store catering to a medium-class trade can offer a wider range of prices than one catering to either the high or the low class. Most stores have found that it is not good policy to attempt to cater to all three classes. The only exceptions are found in small towns which have only one or two stores, or in those communities where practically the entire population is on the same economic level.

One of the fundamental advantages of a department store is its shopping facilities. If a store is to get this advantage it must offer, in its different lines, price ranges which will appeal to about the same type of customer throughout, so

that each line will draw customers for other lines. This is one of the most fundamental principles of retail merchandising. It is the function of the merchandise manager to correlate the price ranges so that one buyer is not catering to a very high class of trade and another to a low class. For instance, if the price ranges in dresses are high as compared with those of competitive stores, the ranges in coats, millinery, shoes, and hose should also be high, that stores may get full advantage of their shopping facilities.

Nearly all of the larger retail stores have adopted a "one-price-to-all" policy and have thus increased the general confidence in the retail-price level. The essential feature of the one-price system is that it removes from the unscrupulous salesperson or store manager the opportunity to sell at different prices, thus causing waste of time in haggling and ultimate ill will on the part of a large number of customers. One price to all means simply that at any particular time the merchandise is offered to all customers at the same price. This price may be varied from day to day, or even from hour to hour, so that a customer buying one day may pay a much higher price than if the purchase were made a day later. This is especially true with style or novelty merchandise, where the price depends directly upon the state of mind of the customer as affected by the particular stage of the style cycle. After the general adoption of the one-price system, it becomes necessary for individual stores to adopt a policy or standard method of procedure in arriving at these prices, that, within stores of the same type, a somewhat uniform level of prices will be maintained on similar lines of merchandise.

Factors affecting price.—What the customer will pay for an article determines the upper level of prices, and the cost of selling determines the lower level. Between these two limits the retail price must be determined. In fixing this price, therefore, a buyer must consider: (1) competitors' prices for similar merchandise; (2) what he thinks the customer will pay; (3) departmental overhead; and (4) effect upon future business. Finding one price out of line with competitors, as a rule, will give the general impression of higher prices throughout. For this reason most stores have found that it is not good policy to sell the same or similar goods for more than competitors are selling them. Because of this

policy, there has developed a somewhat uniform level of retail prices, based upon the normal cost of selling particular lines, and the customary charge for certain items of merchandise. Thus competition helps to fix the upper level at which goods shall be sold, not only because of the immediate effect of supply and demand, but because of the future effect upon sales. Recognizing the disadvantage of having prices out of line, most stores follow a systematic procedure in checking competitors' prices before the merchandise is placed in stock. In the larger institutions there is a separate department to shop competitive stores and compare qualities, styles, and prices, with the idea of giving an unbiased or customer's point of view regarding the relative impressions which the merchandise makes.

Underselling policy.—In most communities there is at least one store whose policy is to undersell competitors on all lines of merchandise. Such a policy is effective as an advertising appeal only so far as customers actually find lower prices for comparable merchandise. It is necessary, therefore, in carrying out an underselling policy, to adopt an accurate method of checking competitors' prices before merchandise is placed in stock, and of making price adjustments after sales have been made, or when the customers report a failure to undersell other stores. The stores that have been successful in carrying out this policy are those that have been lenient in making adjustments to customers and have made no exceptions to the rule. It is recognized that a store which has adopted an underselling policy is placed on the defensive in all questions arising in regard to price, and that an attempt to hedge, or to offer exceptions, defeats the very purpose for which the policy has been adopted.

In a community in which the average net profit is 5 per cent, the question naturally arises as to how a store can maintain a 6-per-cent underselling policy and yet show a net profit. There are two plausible answers to a question of this kind. In the first place, an underselling policy is usually adopted by a cash store. By selling for cash the store can operate on a smaller margin of capital and is in a better position to take advantage of available discounts, and to get larger discounts by prepayment. In the second place, if a store actually maintains a policy of this kind, there results an increased sales

volume, and an effective advertising appeal, which mean a more rapid rate of stock turn and consequently lower operating expenses. Still another factor contributing to the operation of an underselling policy is that only a small percentage of merchandise sold in retail stores is easily comparable as to style, quality, and price. As a general rule, the only merchandise which can be identified by customers is that which is branded by manufacturers. In a great many stores this type constitutes less than ten per cent of the total sales. An underselling policy, therefore, may mean that comparable merchandise, such as nationally advertised products, is used simply as loss leaders to attract customers and the profit is made on unbranded merchandise or merchandise manufactured under the store's own brand. Several stores in one community may maintain an underselling policy so long as they do not handle comparable merchandise. The effectiveness of an advertising appeal of this kind is lost if it is used by more than one store, because the belief in one store's advertising simply means a disbelief in the other. This results in a general disbelief in all advertising of this kind.

Effect of style.—A good merchandising policy must necessarily be far-sighted, so that in arriving at the retail price it is necessary to consider not only what competitors are charging but the effect of the present price upon future business. In staple lines of merchandise it is possible for a store to anticipate a general level of prices over a long period, so that the cost of operation of the department and a reasonable net profit are the major factors to be considered in fixing the retail price. In seasonal, style, or novelty merchandise, however, it is necessary to arrive at a net profit through a system of averages, with higher gross margin at the beginning of the season and a gradual decline as the season progresses. This usually results in an actual loss on a certain portion of end-of-season stock. The value of this type of merchandise exists only in the mind of the customer and consists of the satisfaction or pleasure which she expects to get out of it. It is necessary to disregard, to a large degree, the average overhead of the department and the economic value of the individual item and to arrive at the retail price by considering as the major factor the price the customer is willing to pay. If the merchandise can be duplicated by a competitor the

price will, of course, be set by competition. The following example illustrates the fluctuations in the selling price of a line of style merchandise as affected by competition and the demand of the customers:

"Well in advance of the spring season of 1922 the buyer for women's suits in the Cascade Department Store, an eastern metropolitan retail establishment, placed orders for 146 tweed suits. It was his judgment that tweed suits would be popular in the spring of 1922, both because of the general style movement toward sport clothing and also because tweeds, being of loose weave construction, could be manufactured to retail at lower prices than many fancy wool and worsted fabrics. Nevertheless, he did not wish to order tweed suits heavily before he had tried them out on his clientele, since the style trend had been away from suits during the two previous seasons.

"The expense, direct and prorated, in the women's suit department in the Cascade store was normally 26 per cent of net sales, and the net profit normally 4 per cent of net sales. Eighty-one tweed suits, purchased at $25 each, were marked to retail at $48.50, and the other 65 suits in the first order, which were of somewhat less expensive material and cost $20 each, were marked to retail at $35.80. As soon as these suits were placed on sale, it was apparent that tweeds were to be popular. Orders, therefore, were placed for 372 suits. By this time other garment manufacturers had copied the designs of the pioneers in the tweed-suit field, and competition had brought the price to department stores down to $17.50 for suits that previously had cost $20. The Shopping Bureau of the Cascade Department Store reported that competing department stores were selling tweed suits at $30, which were equal in value to those sold by the Cascade store at $35.80. Therefore, as soon as the order was placed for 372 suits at $17.50 each, the retail price on all tweed suits in the department was reduced to $25.

"As the season progressed, sales of tweed suits continued to be large, and more and more manufacturers became engaged in the production of this popular line. Replacement value fell to $15.50, at which figure the suit buyer of the Cascade store, after consulting the merchandise manager,

ordered 156 suits. At that time it was becoming difficult to secure deliveries on the dates promised, and several other department stores, which had not bought tweeds early in the season, were reported to be ordering heavily. By the time these suits were received, competitors were selling similar merchandise at from \$21 to \$23; consequently, the Cascade store reduced the price to \$19.75.

"Toward the end of the season it was evident that the popularity of tweeds was to be short-lived. In the Cascade store 76 suits had been sold at \$48.50, 64 at \$35.80, 295 at \$25, and 138 at \$19.75. There were left in stock 101 suits. Retail prices on these were reduced to \$15 for a widely advertised clearance sale, and at this price 33 suits were sold. Three days later the price was reduced to \$10, at which figure 28 suits were sold. There were still 40 suits left in stock which apparently would not move at a retail price of \$10 each; consequently, rather than to carry any tweed suits over to the next season, the price was brought down to \$5, and at this figure all the remaining suits were disposed of." [1]

On the first purchase of suits the buyer got an initial mark-up of 48.4 per cent; on the second, a mark-up of 44 per cent; on the third, a mark-up of 30 per cent; and on the last purchase of 156, a mark-up of only 21.5 per cent. The initial mark-up on the whole lot was 34 per cent and the maintained mark-up or gross margin was 28.2 per cent. The last 101 suits were sold at an average of \$9.65, which was \$5.85 below the lowest cost, whereas the 76 suits of the first purchase were sold at \$48.50 with a gross margin of 48.4 per cent. This is a typical example of the method at which an average initial mark-up is arrived at in a department carrying style merchandise.

Departmental overhead.—The average cost of selling determines the lower level of selling prices, although in arriving at the retail price of individual items the departmental overhead is of minor importance. A merchant cannot be expected to continue to carry a line of merchandise upon which he makes no profit. If competition or custom has set a retail price which does not allow sufficient gross margin, a buyer may either purchase the merchandise at a lower cost, decrease his

[1] Copeland, Melvin T.: "Problems in Marketing," p. 15.

cost of selling, or discontinue the line, replacing it with a brand which bears a higher gross margin. In many lines of nationally advertised merchandise the gross margin is so narrow that it is not possible for the store to handle them at a profit. This is especially true in toilet articles and drugs which have been used largely by stores as loss leaders.

In some stores an attempt has been made to establish a percentage of mark-up in each department or line of merchandise and to find the retail price by automatically applying this percentage to the cost of the article. These stores feel that by such a plan the department is assured of a mark-up sufficient to yield a net profit. Furthermore, they feel that each item of merchandise will bear its proportionate share of expense, and that with such a plan the buyer will be relieved from the tedious task of determining the retail price and can give more time to the actual functions of buying. Since the buyer knows that his price is fixed he will be more careful not to buy anything which will look weak, expecting to even up the average mark-up by boosting something which looks like a better buy. A further advantage which is claimed for this plan is that it tends to eliminate spotty prices, that is, prices which are out of line with other stores. As customers in shopping discover these prices their confidence in the general price level of the store is affected.

There are several disadvantages, however, to a policy of this kind which makes it impracticable in most lines of merchandise. In the first place, it is not possible to apply the same percentage of mark-up to all items in a department. The cost of merchandise is of little significance to the customer. One of the first principles of pricing is that the merchandise should be marked at a figure at which there is reason to believe it will be sold. The retail price, therefore, is of primary importance and the cost price of secondary importance. If the cost of the merchandise were the same to all stores, and each applied the same percentage of mark-up, there would be a uniform price level. Such a condition would eliminate competition except in service, and would not allow the customer to get the advantage of lower costs due to the efficient operation of individual retail stores.

Inasmuch as the cost of merchandise and departmental overhead vary in different stores, there is no reason to pre-

sume that a uniform mark-up would eliminate spotty prices as compared with competitive stores. Furthermore, such an automatic system of arriving at the retail price does not take into account the customer reaction toward highly seasonal or style merchandise. During the early part of summer, straw hats costing $4 may be sold easily at $6, but during the latter part of August the sale of the same hat would be limited at $1. In other words, an average mark-up does not permit the proper functioning of the law of supply and demand in determining the retail price. In arriving at the retail price of individual items, therefore, there must be continually in the background of consciousness an average mark-up for the department, but this mark-up must not be the determining factor.

Relation of price to type of store.—Since the price at which an article will sell in a retail store is determined solely by the customer, the service and reputation of the concern should be considered in fixing the selling price. Some years ago, an investigation of the cost and selling prices on a piece of well-known broadcloth was made, and disclosed these facts. The mill received $1.65 a yard for the goods delivered in New York. A Fourteenth Street department store sold the goods for $1.85 a yard. A store then on Twenty-third Street sold the same cloth at $2; a Fifth Avenue store, then owned by the parties operating the Twenty-third Street store, sold the cloth at $2.50; while another Fifth Avenue store sold the cloth as "imported" for $3.50 a yard. Curiously enough at the time of the investigation, the store selling at the highest price was buying more of the goods than the other stores.[2] A larger portion of the satisfaction or pleasure which a customer anticipates from the purchase of an article of this kind depends directly upon the fact that it bears a certain label, that it has been approved by a particular institution. The economic value of two items of millinery may be exactly the same, yet one may sell for $10 and the other for $25, depending directly upon the relative status of the institution in the mind of the customer. As a general rule, the reputation for handling quality merchandise must be built up over a period of years. Higher prices naturally accompany better quality, first, because it costs more to produce a quality product, and, second, because higher prices convey the idea of quality.

[2] *Journal of Commerce,* January 28, 1921.

The value of merchandise which is purchased to enhance the customer's appearance, or which contributes to the raising of her social status, is determined largely by the prestige of the particular institution. It is a well-established fact that people are willing to pay more for merchandise that is sold by a house which has established a reputation for making satisfactory adjustments.

Another factor which must be considered in fixing the retail price is the character of the service which the store renders. For example, a can of soup with a retail price of 15 cents may be sold for 14 cents by a store furnishing credit and delivery service, and for 13 cents by a cash-and-carry store. The one cent additional charge for service means an actual increase of 7.7 per cent in the retail price, which is more than enough to pay for the extra services rendered. By adding services which cost only 5 per cent of sales a store is very often able to create an atmosphere which enables it to increase its selling price by double the actual cost of the added service.

In determining the retail price of merchandise, each particular line should be considered separately. Since the ultimate aim of the retailer is to make the largest amount of net profit, the retail price should be fixed with this end in view. A toilet article increased its sales over ten times when the price was reduced from 35 cents to 25 cents, the lower being the customary price. At 19 cents the same article increased its sales to double what it was at 25 cents. At what price should it have been sold? The answer lies in the relative amount of total net profit which is received under the three prices. If the articles cost 15 cents apiece, each item would bring a gross margin of 20 cents when sold at 35 cents and 10 cents when sold at 25 cents. Since the total sales increased ten times when the price was lowered to 25 cents, the total gross margin would be $1. At 19 cents the gross margin in each would be 4 cents, but on twenty, the resulting sales, the total would be 80 cents. Assuming that the cost of selling in each case was 20 per cent, the net profit would be 13 cents, 50 cents, and 4 cents, respectively. If demand is elastic, a merchant may increase his sales by decreasing the selling prices and consequently increase his net profit. However, in some lines of style merchandise a decrease in price affects the demand negatively, that is, the actual sales decrease with a reduction

in the price. This is especially true in style merchandise, where a mark-down creates the impression that the store is admitting a wane in the style or mode.

Basement policy.—To secure the patronage of a wider clientele, some stores have adopted a policy of carrying less expensive lines of merchandise in their basements than are handled by the upstairs departments. In carrying out the policy they are thus able to compete with stores which carry cheaper lines of merchandise and at the same time cater to a higher class of trade in the upstairs store. Some stores, notably Marshall Field & Company of Chicago and the Emporium of San Francisco, run complete basement stores carrying a regular stock in lower-price ranges than upstairs. Another policy followed by some stores is the operation of a bargain basement dealing only in job lots, seconds, mill ends, and broken lines of merchandise which may be purchased at low figures and thus sold to the public at greatly reduced prices. The policy of the basement depends largely upon the type of merchandise handled in the main store. The first requisite in the operation of a basement is that all competition be removed between the upstairs and the downstairs store. Different price lines and brands should be carried, so that direct competition and comparison will be eliminated. In the basement of one store the prices for men's suits are regularly \$15, \$20, \$25, and \$35, and in the upstairs store \$25, \$35, \$50, and \$75. This gives a very complete price range for two classes of trade.

Competition in brands sometimes results at the close of a season, when the basement buyer is buying job lots, and may be showing the same brands at lower prices than the upstairs store. In well-organized stores, however, the policy is to have the buyers check and compare sources, so that the prestige of the upstairs store will not suffer because of the basement lines. There is a conflict of opinion as to whether the downstairs should be used at the end of the season as a clearing house for the upstairs store. One opinion is that the sale of merchandise in the basement creates ill will on the part of the customers who have bought the same merchandise upstairs at higher prices. On the other hand, it is held that when a large mark-down is taken on merchandise it should be

moved from its original department, so that the regular customers will not come so directly in contact with it.

Another factor to be considered is that, by having the merchandise in the upstairs store, the regular customers will get the advantage of the mark-down. The tendency is for stores to merchandise the upstairs and basement separately.

The success of basement merchandising depends largely upon the rate of turnover. In order to stimulate the buyer to buy and price merchandise that will move quickly, some stores have adopted an automatic system of reduction. For instance, after 12 selling days, goods are reduced 25 per cent, after 18 selling days, 50 per cent, after 24 selling days, 75 per cent, and after 30 selling days they are given away. Under such a system the basement is assured of a minimum turnover once a month. The automatic bargain basement of Wm. Filene's Sons Company in Boston, working under this plan, lost over $20,000 a month for the first few months it was in operation, because people waited for the different markdowns. After two or three months, however, they found that the goods were gone when they came to buy. On the average, goods in this store are now sold at the first price, because the buyers have learned that they cannot buy to make a profit, unless they buy cheaply enough to make the customers sure that they are getting extraordinary value at the first price.

Exclusive agency.—In order to eliminate competition and price-cutting in particular lines of merchandise, some retail stores, by agreement with manufacturers, get the exclusive right to sell a commodity within a certain territory. Although the terms of an exclusive agency agreement vary in detail, the essential element is that the manufacturer agrees to refrain from selling merchandise under his brand to competitors of the store and, in turn, the retailer usually agrees to carry no competing brands. The retailer's agreement to sell no competing brands is limited, however, by the decision of the Supreme Court of the United States in Standard Fashion Company *v.* Magrane-Houston Company of April 10, 1922. In this decision the Court held a contract to be illegal which stipulates that the retail company should not be permitted to sell any competing brands in its store. This decision was rendered under the Clayton Act, the object of which was to keep the market open for all sellers. Section 3

of this act provides that it shall be unlawful for any person engaged in commerce to lease or make a sale of goods, or fix a price, or discount from, or rebate upon, such price, on the condition that the lessee or purchaser thereof shall not use or deal in the goods of a competitor, where the effect of such lease, or sale, may be substantially to lessen competition.

From the retailer's standpoint the advantage of an exclusive agency lies in the gain in prestige which comes from the association of his name with a nationally known product. He gets all the benefit in his community of the manufacturer's advertising and, in addition, he may concentrate his advertising and selling efforts without sharing the return with competitors. By carrying only one brand he is able to maintain a complete stock with a minimum investment. In some instances, the agreement stipulates that the retailer must carry a full stock and buy a stated quantity of merchandise each season or year, as a condition for retaining the agency. This requirement sometimes works a hardship on the retailer by compelling him to buy an excess stock of goods, thus decreasing his rate of stock turn. By confining purchases to one line the retailer can buy in larger quantities than when he scatters among different lines, thereby getting the best possible terms and service. Furthermore, he removes the hazards of unfair competition on the part of stores that use nationally advertised merchandise as loss leaders. This is especially true in high-priced lines, where much of the retailer's capital is tied up. In such lines he cannot afford to carry many other brands of goods, so, in case of price wars, it is not possible for him to shift his selling efforts to other lines.

The chief disadvantage of an exclusive agency is that the manufacturers sometimes control the sales policy as to price and stocks. The store is thus limited to one line, which the manufacturer may withdraw after the business has been built up. The price at which the manufacturer desires his product to be sold may be more than the merchant can afford to charge. This is especially true when competitors are cutting prices on competing lines, or when some other line ordinarily sells for less. Unless the commodity has some exceptional characteristics which tend to maintain the customer's preference, sales will be lost because of the lower prices of competing brands.

Another factor to be considered in accepting an exclusive agency is that a customer's preference changes quickly from one brand to another, because of the large amount of national advertising. Sales are lost because retailers cannot satisfy this preference. Again, there is always danger of a loss from a shortage of supply from the manufacturer. If a retailer builds up a successful trade for one brand and this supply is cut off he suffers from a loss of institution prestige as well as from a loss of immediate sales. Because of the increasing number of nationally advertised products, the tendency is toward a decreasing number of exclusive agencies except in the very high-priced merchandise. The Mallory Hat Company, in 1921, discontinued its exclusive agency plan in New York City, where it had sold its brand of hats through one retail agency for 98 years. In 1921, the company began to sell to four large retail firms and to a large number of smaller retailers in New York. A large increase in sales was stated to have resulted from the change.[3]

The exclusive agency system is used mostly for specialty goods. As a general rule, it has no place in the distribution of convenience goods which, by their very nature, should be on sale in the most readily accessible stores. An exclusive agency for shopping goods is disadvantageous except in higher-priced goods, as it handicaps the store in its selection of seasonal goods and novelties. The exclusive agency method usually favors the manufacturer, wholesaler, or retailer who has not reached a strong position in the market. If a store is well established and has an institutional prestige in a community, there is no particular advantage in signing an agreement to handle only one brand of merchandise on which the manufacturer is allowed to fix the margin of gross mark-up.

Resale price.—It has been definitely decided by the Supreme Court of the United States in a series of decisions under the Clayton Anti-Trust Act and the Sherman Law that the retailer cannot legally be prevented from selling merchandise at any price he may choose. While a manufacturer can refuse to sell to a merchant, it has been declared illegal for a manufacturer to put into effect any organized plan for obtaining a list of names of retailers that cut prices in order

[3] Tandy, Edward T.: "Drops Exclusive Agency Plan and Sales Increase Tenfold," *Printers' Ink,* Sept. 8, 1921, pp. 57-64.

to cut off their purchases. The essence of these decisions is that, if a manufacturer parts with the title of his product, he cannot control the resale price. In Federal Trade Commission *v.* Beech-Nut Packing Company the Court ruled that refusal to sell was in contravention to the law, provided the refusal was directly, or by implication, conditional upon the maintenance of resale price. One of the chief arguments against price maintenance is that, inasmuch as the cost of doing business varies widely in different types of stores, a merchant that operates efficiently would not be able to pass on the benefits of a low-expense ratio to his customers. In other words, resale-price maintenance by manufacturers would destroy, to a very large degree, competition between merchants.

A further disadvantage is that it is impossible for a manufacturer to predetermine a resale price which will be equable to the merchant and to the consumers in all communities. Such a plan fails to make provision for the store which does not offer credit, delivery, or other services. A store of this kind could not compete except by offering the customer a saving through lower prices. If the resale price were controlled by the manufacturer, the chain stores could not handle nationally advertised brands of merchandise. Another disadvantage of resale price maintenance is that the value of seasonal merchandise varies greatly with the time of the season, so that it is not possible to arrive at an average fixed price which would insure sufficient gross margin in the season's operation.

On the other hand, predatory price-cutting, whereby a merchant trades on the reputation of a manufacturer's brand, is undesirable merchandising. After the manufacturer by advertising has established in the mind of the consumer a certain standard of quality, some merchants advertise this product at a price which is very much below the recognized resale price, in order to draw people into the store. The reduction in nationally advertised goods is more tangible and more readily believed than a reduction on unbranded products. This practice is especially common in drug stores which sell nationally advertised toilet articles at or below cost in order to attract customers into the store for the purpose of selling them other less well-known merchandise or private-brand

goods, on which a higher margin of profit is secured. The result is that many retail institutions refuse to sell nationally advertised products except as loss leaders. As a general rule the cutting of prices on branded products results in an ultimate depreciation of the value of the product in the customer's mind. When it loses its pulling power it is discontinued by the retailer. Such practice is misleading to the public and is unfair to the manufacturer. Good merchandising practice requires that the retail price should be adequate to cover operating expenses and yield a normal net profit. The variation in resale price, therefore, will correspond mainly to the difference in operating expense as affected by location and efficiency.

Private Brands.

When a retail institution has gained a certain amount of prestige in a community it may decide to assume the responsibilities for certain lines of merchandise which it handles and therefore places its private brand upon its goods. A brand or trade-mark simply indicates the merchant who assumes the commercial responsibility for the quality of the product which bears the mark. The initial strength of a brand, therefore, depends directly upon the reputation of the institution itself, and its ultimate value is determined by the regularity with which the quality is maintained. In the initial stage of the development of private brands the merchant's name or label is attached to certain lines of merchandise by the manufacturer. The store name may be used as a part of the registered brand name, as "McCreery Silks," of James McCreery & Co., New York. When a store places its private brand upon the goods it takes upon itself the burden of sales promotion. The first factor, therefore, in determining whether a private brand is to be used is the possible sales volume of the particular product and also the relative strength of institutional prestige.

The branded name may be applied to a number of different types of merchandise carried in different lines or to a specific line. Franklin Simon & Co., for example, uses the "Bramley" trade-mark for dresses, suits, and coats, and James McCreery & Co. uses "Master Made" as a trade-mark for most of its furniture products. The question naturally

arises as to the advisability of a blanket trade-mark for a number of different types of merchandise. Such a trade-mark ordinarily is advantageous only when the products are closely allied in use, and uniform in style, value, and quality, so that each line will maintain the standard of the blanket trade-mark. For example, it would not be good merchandising policy to apply a trade-mark which implied style in women's ready-to-wear to a line of furniture or rugs. In applying a blanket trade-mark to a wide variety of articles there is danger of inferior quality in some of the lines, which naturally results in an injury to the reputation of the whole line.

Another problem which arises in the use of a brand name is the number of different prices or grades which can be advantageously carried under one brand. If the name indicates style and exclusiveness, the price ranges must necessarily be limited to appeal to a particular clientele. If, however, it signifies dependable quality the number of price lines may be in accordance with the class of trade to which the store caters. For instance, a store on Fifth Avenue, New York, carries its own private brand of hosiery in a wide variety of price lines. In an article such as this the trade-mark indicates value or quality for the price paid, so that the problem is not so much the number of price lines as the maintenance of a certain standard of quality in each line. It should not be necessary for a reputable institution to make any special guarantee on its branded lines, as its general policy of satisfaction to customers is implied. A special guarantee of specific products usually results in a depreciation in the value of products not specially guaranteed. If a store is handling a medium-priced line of trade-marked merchandise, it may advertise a higher-priced line in order to add to the prestige and stimulate sales in the medium-priced merchandise. Experience has shown that it is good policy to include a few high-priced goods, even though small sales are made from such high-priced lines.

The ownership of a brand carries with it the responsibility for the quality of the product and the burden of aggressive sales promotion. The manufacturer who accepts orders for goods on which the retailer's private brand is to be placed, therefore, has little advertising expense and devotes his entire attention to production. The choice of a dependable

manufacturer is of major importance if the quality of the brand is to be maintained. In order to insure this quality some retailers manufacture their own merchandise. This is practicable only in institutions which are highly organized and have large sales volume in the branded merchandise. As a general rule, it is not good policy for a store to be dependent upon one manufacturer for the entire output, unless that manufacturer is under the direct control of the store, since, after the brand has been well established, a manufacturer may dictate price or terms, or fail to produce the required amount. On the other hand, a store must insure itself of uniform service, quality, and price, if different sources are used for the merchandise.

In choosing a trade-mark for a private brand care should be taken that it is a name which can be registered at the United States Patent Office. A brand which is worthy of use and promotion should necessarily be registered with the Federal Government, in order that the registrant may be accorded prima facie evidence of the ownership of the mark. After the trade-mark has been registered the registrant may bring suit for infringement and the burden of proof always rests with the one accused of infringement or unfair trading. A trade-name for a retail store, above all things, should be short, easily pronounced, and suggestive of value and worth. It should be pleasing and appropriate to the product for which it stands. Finally, it should be distinctive, that it may be easily recognized and remembered.

Private brands for associated stores.—Private brands in some instances have been successfully used by groups of non-competing associated stores, and there is, at the present time, a rapid growth in this practice, especially in ladies' ready-to-wear. One group of stores has been particularly successful in merchandising dresses under a private trade-mark. The large volume of total business done by these stores enables them to secure lower prices from manufacturers than is possible for individual stores. In selecting the dress which is to be sold under the brand, the procedure is as follows: A new dress is sold each month under the brand name. Preliminary to the selection of the dress by the store, the resident buyers make a careful survey of the market, designating an average of about four models from each of the manufacturers

that have suitable lines. These models are then sent to the resident buying offices on the day on which the selection is to be made. The total number of models from which selections are made may range as high as one hundred. The dress is selected by the buyers of the individual stores, so that they will feel the responsibility of taking their quota and pushing the sales. Inasmuch as the dress has a fixed purchase and resale price, the selection is made on the basis of the best value shown by the manufacturers. By giving the manufacturer a guaranty for a large order of dresses, it is possible to get a much better value than when he takes the risk of manufacturing in small quantities. Some associations have advertised their private brands nationally in style magazines and have built up a large volume of business in this class of merchandise. In one association the cost of the dresses sold under a private brand is $26 with terms 8 per cent 10 days. The stores are charged $26 net and the discount used to defray the cost of national advertising. The retail price of the dresses is $39.50, giving an initial mark-up of approximately 34 per cent, which is lower than the normal purchase mark-up in dresses. Inasmuch as the mark-downs in the privately branded dresses are small, however, amounting in one group of stores to approximately 1 per cent, the maintained mark-up in this same group is comparatively high for this type of merchandise.

Returned Merchandise.

The reason for the return, and the amount of goods which are returned, by customers vary because of the nature of the merchandise and the policy of the store in its selling methods. The common figure for 26 specialty stores reporting to the Harvard Bureau of Business Research was 12.4 per cent of gross sales in 1923, with a range from below 5 per cent to above 20 per cent. During the same year the return for the larger group of department stores showed a common figure of 6.2 per cent of gross sales and 2 per cent for stores below $1,000,000. The percentage of returns for 8 stores, as compiled by the Retail Trade Board of the Boston Chamber of Commerce, Table 28, varies from 5.4 per cent to 19.7 per cent:

TABLE 28

PERCENTAGE OF RETURNS IN EIGHT BOSTON STORES

	Store 1	Store 2	Store 3	Store 4	Store 5	Store 6	Store 7	Store 8
1. Per cent of total returns to total business * in men's and boys' outer wearing apparel dept.	14.2	4.6	...	11.1	13.58	...	17.1	...
2. Per cent of total returns to total business † in women's outer wearing apparel dept.	26.3	11.9	26.9	22.3	33.71	...	21.4	...
3. Per cent of total returns to total business ‡ in children's and juniors' outer wearing apparel dept.	21.3	7.9	...	22.7	34.26	...	18.1	...
4. Per cent of total returns to total business for store.	17.3	5.4	19.7	11.3	16.31	10.9	14.8	...
5. Per cent of total cash returns to total business for store	7.5	3.4	5.8	4.5	5.86	4.2	6.7	7.4
6. Per cent of total C.O.D. returns to total C.O.D. business for store	13.5	11.1	8.9	25.6	10.86	22.1	7.0	29.1
7. Per cent of total charge account returns to total charge business for store.	28.2	10.9	24.2	16.3	21.78	20.3	23.2	24.1

* To include suits, coats, trousers, hats.
† To include suits, coats, skirts, gowns.
‡ To include suits, coats, skirts, dresses.

In a similar study, made by the Controllers' Congress of the National Retail Dry Goods Association, of stores in thirteen larger retailing centers, the total returned goods ranged from 5.01 per cent to 23 per cent of the total business of the store.

A more detailed study of returned merchandise shows that, as a general rule, the percentage is higher in charge and C.O.D. sales than in cash transactions. In a study made by the Controllers' Congress, the percentage of returned cash sales to total cash sales varies from 1 to 8, the percentage of

returned charge sales to total charge sales from 2.94 to 25.8, and that of C.O.D. sales from 5.6 to 36 per cent. About the same divergence is shown by the Boston stores (Table 28). Carrying the analysis still further it is found that wearing apparel usually shows the highest percentage of return of any line of merchandise carried in department stores. This accounts in part for the high ratio of returns in specialty stores.

It is generally recognized that a high percentage of returns tends to increase the operating expenses of stores.[1] Not only does returned merchandise incur double selling expenses, but sales opportunities may be lost while such goods are out of the store. Furthermore, there is a high rate of depreciation due to soiled and damaged stock which has been taken to the customer's home and returned. In addition a large percentage of merchandise returned must be called for by the delivery department which constitutes an added expense. On the other hand, the return privilege helps to break down sales resistance and encourages customers to buy more liberally.

Causes of returns.—The condition under which the sale is made and the state of mind of the customer at the time of making the purchase determine to a large degree whether the merchandise will be returned. It is easy to understand that articles of wearing apparel are more likely to be returned than merchandise of other kinds. Customers purchasing such merchandise usually desire to select from the whole shopping area and to make comparison of style, quality, and price in more than one store. Consequently, the merchandise is tentatively purchased to make comparison at home. The relative amount of purchases which are returned depends, to a large degree, upon the customer's feeling regarding the ease with which returns may be made. It is presumed in a sale that the value of the merchandise in the customer's mind is above the price. If this is true, then the merchandise will not be returned until this value or estimation of the merchandise declines. It is the function of the salesperson to present the

[1] There is reason to believe that the reverse of this also holds true as indicated by the statement of one department store for 1922. This firm with net sales well over $25,000,000 had returns and allowances amounting to only .8 per cent of gross sales, and direct-selling salaries and wages constituted only 4.6 per cent of net sales as compared with the average of 5.9 per cent for this size of store.

merchandise in such a way as to bring out its value-giving qualities, and to raise the customer's estimate of it.

A sale may be made at any time that the customer feels the merchandise is worth as much or more than the price. After the goods have been received the value may decline for various reasons, such as failure to get the approval of members of the family, colors show up differently in the home, size not right, does not match surroundings, or does not compare favorably with merchandise from other stores. The percentage of returned merchandise will depend upon the relative amount of inconvenience in sending the goods back and the customer's feeling about the store's attitude toward returned goods. If it readily accepts returned merchandise, asking no questions and causing the customer no inconvenience, the percentage of merchandise returned will, in most cases, be high. Thus, leniency in accepting returned merchandise has a dual effect upon the amount of returned merchandise. The thought that it may be returned causes the customer to buy more when in doubt, and the thought that it may be returned easily causes her to return more.

Another cause of returned merchandise is a malicious abuse of the privilege on the part of customers who purchase merchandise to copy it, to make an impression on friends, or to use it for special occasions. To a large degree this constitutes a direct loss to the store, in that it does not contribute to a potential increase in sales volume. The only method by which a store can protect itself from an abuse of this kind is to check the activities of customers who continually abuse the return privilege. This is made possible for stores operating on a charge basis by the interchange of information concerning such customers through a coöperative organization of credit men.

Statistical studies show that a large percentage of returns is due to clerical errors, defective or damaged merchandise, wrong merchandise, and wrong size or color. The responsibilities of these returns cannot be allocated wholly to the store or to the customer. In some stores wrong size and color constitute as high as 20 per cent of returned goods. This can be accounted for only by a lack of standardization of sizes, failure to get the proper measurement at the time of purchase, or to the fact that a large percentage of mer-

chandise in which sizes are involved is purchased by one member of the family for the use of other members.

Return policy.—Most stores have set a definite time limit beyond which returns will not be accepted except in special cases. These limits vary from two to ten days. In some communities the limit has been made uniform, so that customers could not use the leniency of one store as an argument against another store's policy. A time limit is set primarily as a psychological influence on the customer to encourage her to return the merchandise as quickly as possible. Some stores feel that a time limit of 7 days influences about 90 per cent of the customers either to return the merchandise within that time or not at all. If the merchandise is returned after the limit it is usually accepted, but the store makes the customer feel it is a special privilege. Thus, a limit acts to decrease the length of time merchandise is out of the store and to increase the goodwill of the few customers who are made to feel that they have been granted a special privilege. As a general rule, it is good policy to accept all merchandise which is in good condition regardless of time. In some communities the retail store, working through the Chamber of Commerce and the Commissioner of Health, has been able to get uniform regulations adopted preventing the return of certain articles of personal use.

Special problems arise in regard to the return of gifts, piece goods, which have been cut at the request of the customer, and merchandise bearing non-detachable tags. In all of these problems the policy of the store must be in accordance with the clientele which it is serving and the merits of the individual case. If merchandise is not satisfactory to the customer, most far-sighted merchants welcome its return, because they recognize that the ultimate success of a store depends upon the satisfaction which customers experience with their purchases. A store which accepts no returns, or accepts them under protest, may prevent an immediate loss, but usually sustains a greater ultimate loss through ill will. It is presumed that merchandise is accepted by the store as a service to the customer to increase her goodwill and thus to contribute to future potential sales volume. The first essential, therefore, in determining a policy for handling returns is to make certain that the customer's goodwill is retained.

Returns may be the result of the overselling of merchandise which does not actually compare with that of competition, or they may be caused by insistent selling. The customer may have merchandise sent to her home rather than suffer the displeasure of excusing herself from an insistent salesperson. In this condition the value at the time of purchase is still below the price of the article. In order to prevent this type of overselling, some stores penalize the salesperson by deducting twice the amount of the returned merchandise in arriving at net sales as a basis of payment.

The first essential in decreasing the number of returns because of errors on the part of employees is to adopt a follow-up which will assure the allocation of responsibility for the error, and secondly to provide an incentive, either in the form of a reward for minimum errors or a penalty for a large number of errors. The solution of the returned-goods problem is to be found, not so much in the adoption of general restriction on their acceptance, as by an analysis of their pyschological causes and the introduction of better selling methods. Competition among merchants in offering service to the customer and in striving for higher sales volume is responsible to a large degree for the high percentage of returned goods. Concerted work in educating the public regarding the cost to the community seems to offer the most logical solution.

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Problems.

1. On page 320 an example is given of the fluctuations in selling price of a line of style merchandise as affected by competition.

(*a*) What would have been the net profit on tweed suits if the last lot of 156 suits had not been purchased?
(*b*) What were the major factors which influenced the retail price of the different purchases?
(*c*) Should the buyer have ordered the last lot of 156 suits?

2. During the early part of the summer of 1924 a buyer in the Cascade department store was able to purchase at reduced prices a large lot of women's bathing suits from a manufacturer who was going out of business. The normal retail price for this quality of bathing suits was $10, but the buyer would be able to sell the special purchase at $8 each and still show his normal mark-up. In discussing the purchase with the merchandise manager the following factors were considered: The demand for bathing suits was just beginning and the retail price would not normally break for four or five weeks yet. The special purchase was only about half enough to take care of the total season's sales, so that the buyer would have to go into the market and purchase at normal prices for the remainder of the season. If the bathing suits were advertised as a special purchase and offered at prices far below the normal prices it would have a tendency to cause a general reduction in prices by competitors before the regular seasonal break. The Cascade department store is located in a large city in the East near several bathing resorts.

How should the buyer have priced the special purchase of bathing suits?

3. Several bills have been introduced into Congress from time to time to grant manufacturers the privilege, under stipulated conditions, of maintaining resale prices. In 1919 a bill was introduced by Mr. Kelly requiring that every vendor, electing to maintain resale prices in accordance with the conditions of the bill, must file with the Federal

Trade Commission a statement of his brand or trade-mark and a schedule of the prices to wholesalers, retailers, and the public. The bill required that prices should be uniform to each class of dealer, except for variations caused by differences in grade, quality, or quantity of the article sold, the place of delivery, and the terms of settlement. All these variations in prices were to be stated in the schedule filed with the Federal Trade Commission.

(*a*) Would it be to the advantage of department stores to encourage the enactment of legislation such as was proposed by Mr. Kelly?

(*b*) The Hench department store is located in a city of 500,000 population. This store caters to the middle and higher class of trade, granting credit and offering a wide range of services to its customers. Because of the underselling policy of one of the larger stores, the Hench store has not been able to handle any considerable amount of branded or nationally advertised products. Should the Hench store favor the enactment of the Kelly Bill?

4. The Park Lane department store in New York City operates a ready-to-wear department in which the annual sales are $2,000,000. This store sells most of its merchandise under its own label. It handles only a very small amount of nationally advertised goods. It has built up a good reputation for high-priced and medium-priced ready-to-wear. At a recent meeting of the store executives the buyer of dresses expressed his opinion that it would be a good plan to choose a trade-mark for dresses and advertise them under a branded name. He pointed to the fact that one of the competing stores was a member of an association which was advertising a "Mary Lee" dress. Another plan which was proposed by the merchandise manager was that the ready-to-wear department should adopt the name "Park Lane" as a blanket trade-mark for all lines of ready-to-wear. The buyer did not think that the store's name would be an effective branded name for dresses. Furthermore, he felt that the same name should not be applied to coats or suits as was used for dresses. One of the members of the firm was opposed to using any type of branded name for ready-to-wear. He felt that the store's name at the top of the advertising sheet was sufficient to identify the merchandise sold by the Park Lane store.

(*a*) What are the particular advantages and disadvantages of each of the three proposals?

(*b*) Which of the three proposals should be adopted?

5. The Wade department store has an annual sales volume of approximately $30,000,000. It is one of the oldest stores in a large

New England city and a large portion of its business is with the well-to-do class of people who have been buying regularly from this store for many years.

Its reputation has been built largely upon the service it renders its customers and the fairness with which it makes adjustments. The management of this store has been very much opposed to any type of special sales events except the end-of-season clearance sales. During the last two years, however, the furniture buyer has adopted three or four yearly sales events during which furniture is sold at greatly reduced prices. During one of these sales an old customer came to the buyer and complained that a suite of furniture for which she had paid $450 the previous week was now shown on the floor for $370. She said that inasmuch as the merchandise was charged she proposed to pay only $370 when her monthly bill was sent to her. She contended that, as the store's advertising stressed a "one-price policy," she did not consider it fair to charge her $80 more than the same merchandise was sold for one week later. The buyer referred her to the adjustment department which refused to allow the reduction in price. The customer ordered the furniture returned and immediately purchased a new set at the sale price.

How should the complaint have been adjusted?

6. The Ames Company, manufacturers of millinery in New York City, recently advertised that if their clients failed to sell 50 per cent of an order of millinery they might return the unsold part to the Ames Company and receive credit. It was held by the competitors of the Ames Company that such a practice is virtually the same as memorandum shipping, which is being discouraged by the Millinery Association. In support of its policy the Ames Company stated that it had always been willing to accept the cancellation of orders from retailers who had overbought. It was felt that by accepting the return of the millinery the Ames Company could minimize the total losses by shipping the returned merchandise to another section of the country. The opponents of the policy contended that it encourages overordering and undue optimism on the part of buyers, resulting in a large back-flow of merchandise and a consequent increased cost of production.

Is the Ames Company justified in its policy?

Chapter XIV

CURRENT MERCHANDISING STATISTICS

In the preceding chapters emphasis has been laid upon the importance of bringing about the proper relation between sales, stocks, and profits. Although this is primarily an internal problem, merchants in general have recognized the similarity in the problems of the different stores and have developed a systematic interchange of information and merchandising statistics. This has been, perhaps, the most important factor in the development of a more scientific method of retail distribution. It has been initiated chiefly by trade associations with the general idea that it will tend either to eliminate ignorant and uneconomic competition or to correct unscientific practices. Statistics show that in many cases the small merchant is operating at a loss through his inability accurately to determine costs. In doing so he forces down the price of certain commodities so that his competitors also lose money if they meet competition. There are, at the present time, several types of services and current data made available to the different stores through associations, and private and governmental agencies.

Controllers' Congress reports.—The Controllers' Congress of the National Retail Dry Goods Association sends a monthly sales barometer [1] to its members, showing the relation between department-store sales of the current month and the corresponding month of the preceding year by Federal Reserve districts. This report is compiled the first of each month from the figures sent in by the member stores. The effect of increases or decreases in individual stores is weighted

[1] The sales barometer of the Controllers' Congress has recently been merged with the sales reports issued monthly by the Federal Reserve Board. Under the new plan the joint sales report for the store as a whole is issued the tenth of the succeeding month. Departmental figures and other data are issued about the twentieth of the succeeding month. The departmental sales are classified under 45 different lines of merchandise.

according to the relative volume of sales. For example, a decrease of 5 per cent in sales, in a store with sales of $5,000,000, would be equivalent to a decrease of 10 per cent in a store with a sales volume of $2,500,000.

In addition to the report of sales for the store as a whole this association compiles a departmental sales barometer showing the relation between the sales of the current month and those of the preceding year for twenty-three lines of merchandise. This report indicates the common percentage change and range for the month and the same for the year to date by Federal Reserve districts as shown below:

	APRIL			YEAR TO DATE		
Departments	*Range, Per Cent*	*Com. Fig., Per Cent*	*Your Fig., Per Cent*	*Range, Per Cent*	*Com. Fig., Per Cent*	*Your Fig., Per Cent*
Silks and velvets....	—23 to 11	—5		—25 to 14	—7	
Dress goods	—34 to 20	—4		—19 to 27	7	
Linens and domestics	—28 to 13	—7		—25 to 25	2	

A merchant may use a report of this kind as an index of general conditions in particular lines and may thereby judge more accurately the relative strength of different departments. There is a weakness in the use of the sales of the preceding year as a basis in figuring the percentage of increase or decrease. For example, if the sales of the preceding year were 10 per cent below normal and this year they were just normal the percentage increase would be 11, although the sales volume would be actually the same as that of two years preceding. Conversely, a large increase in the preceding year's sales over those of the year before gives a base which is out of line with normal. If the sales for June, 1922, 1923, and 1924 were $75,000, $100,000, and $75,000, respectively, the increase in 1923 would be 33 1-3 per cent, and the decrease in 1924, 25 per cent, although the sales in 1922 and 1924 were the same. In the use of a sales barometer of this kind, therefore, a merchant must consider the relation of the preceding year's figures to normal.

Federal Reserve Board.—A total of 333 department stores report their sales to the Federal Reserve Board and 286 report their stocks. These sales and stocks are shown for each district and in total, as relative to some period used as a base

of 100. This base may be the average month of 1919 or the corresponding month of some preceding year. An index for the sales of mail-order houses, ten-cent stores, and chain stores is also published in the same way as department stores. The collection and publication by the Federal Reserve Board of the sales and stock figures for retail stores have given an index by which each retail store may measure its relative increase and decrease as compared to its Federal Reserve district. In some Federal Reserve districts a monthly analysis of department store sales is made by lines of merchandise and the percentage of change shown over the corresponding month of the preceding year as indicated by the following:

Items	*Per Cent Change in Sales Over July, 1923*	*Per Cent Sales of Each Dept. to Sales of All Departments*
Men's and boys' wear	+33.8	8.1
Furniture	+13.7	7.1
Hosiery	+12.5	3.8
Women's ready-to-wear accessories	+11.6	17.8
Silk goods	+ 5.8	5.0
Shoes	+ 5.0	3.9
Home furnishings	+ 3.2	12.9
Women's and misses' ready-to-wear	+ 2.8	8.5
Woolen goods	+ 1.1	1.0
Cotton goods	+ 0.4	5.8
Miscellaneous	+ 5.1	26.1

Statistics of associated stores.—More detailed data are exchanged within groups of associated stores, such as the Specialty Stores Association, Associated Dry Goods Corporation, and the Associated Merchandising Corporation. Inasmuch as the stores of these associations are more nearly alike in their merchandising policies and methods of operation than independent stores, their figures are more comparable. Most of these groups have adopted the same classification of merchandise and expenses, so that accurate comparisons are possible among stores and among individual departments. In one of these groups of stores monthly comparisons by departments are made of stock on order, markup percentage, stock turnover, net sales, and mark-down, as shown in Figure 44. This group of stores also makes a com-

parison of planned figures for these items based upon the past experience of each of the member stores. A best-selling report is sent weekly to each member of the association showing the garment, manufacturer, material, style, terms, color, and price of the best-selling items in each of the major departments.

The Expense Review (Fig. 45) is an example of the data interchanged monthly by one association of retail stores. In addition to the expense data for the store as a whole, there are interchanged monthly expense figures by departments for selling, advertising, and other major direct expenses. Inasmuch as most associations have the same merchandise classification and departmentalization, these expense and merchandise figures give an accurate comparison of the relative

MONTHLY STOCK, SALES AND MARK DOWN REPORT

STORE No. ______

MONTH __________ 192__

Departments	Stock at Retail First of Month		Stock at Retail End of Month		Mdse. on Order End of Month	MARK-UP Landed to 10%		Stock Turnover Season to Date		NET SALES For Month		Increase (Decrease)	NET SALES Season to Date		Increase (Decrease)	MARK-DOWNS Amount for Month		MARK-DOWNS % for Season	
	Last Year	This Year	Last Year	This Year	This Year	Last Year	This Year	Last Year	This Year	Last Year	This Year	%	Last Year	This Year	%	Last Year	This Year	Last Year	This Year
Women's Suits																			
Misses' Suits																			
Women's Coats																			
Misses' Coats																			
Women's Dresses																			
Waists																			
Sweaters																			
Negligees																			
Underwear Silk and Lingerie																			
TOTAL STORE																			

Fig. 44—Monthly Stock Report.

status of the different departments as to costs and efficiency of operation. The advantage of interchanging comparable data of this kind is that the most efficient performance of the group is brought to the attention of each member. If the rate of stock turn is high in a particular store the analysis by departments will show the cause. Similarly, if total expenses are low the detailed classification shows what particular items contribute to the low expense. If expenses or merchandise data are out of line a detailed study may be made by the executives of the different member stores. Thus, with the interchanging of data and experience the inefficiencies are not only located but may be overcome.

In addition to the interchanging of statistics an association of stores usually maintains an office and a group of resident buyers in the central market. Through these resident buyers a current study is made of market conditions as to price, de-

Store #
Month
Year

Budget ☐
Revised ☐
Actual ☐

Check one

SALES

Classification	Amount	%
ADMINISTRATION		
Executive Offices		
Salaries		
Other executive office expense......		
Total		
Accounting and General Office		
Salaries		
Supplies		
Other accounting and general office expense		
Total		
Credit Office		
Salaries		
Supplies		
Other credit office expense..........		
Total		
General Store		
Salaries		
Fixed charges (interest, etc.).......		
Supplies		
Other general store expense........		
Total		
Administrative salaries		
All other administrative expense.......		
Total administrative expense...........		

Classification	Amount	%
BUYING		
Merchandising		
Buyers' salaries		
" bonus		
" travel		
Merchandise office salaries.........		
Other merchandise office expense...		
New York office salaries...........		
Other New York office expense.....		
Total		
Receiving, Marking and Stock		
Salaries		
Other receiving, marking and stock expense		
Total		
Buying salaries		
All other buying expense.............		
Total buying expense.................		
SELLING		
General Selling		
Sales force salaries		
" " bonus		
Other department salaries..........		
Other general selling salaries......		
Supplies		

OCCUPANCY		
Building Maintenance		
Salaries		
Rent paid or interest..............		
Fixed charges (interest, etc.).......		
Supplies		
Repairs		
Other building maintenance expense		
Total		
Light, Heat and Power		
Salaries		
Other light, heat and power expense		
Total		
Occupancy salaries		
All other occupancy expense...........		
Total occupancy expense.............		
PUBLICITY		
Advertising		
Salaries		
Newspapers and other publications..		
Supplies		
Other advertising expense..........		
Total		

PUBLICITY (*Continued*)	
Display	
Salaries	
Rent	
Supplies	
Other display expense.............	
Total	
Publicity salaries	
All other publicity expense............	
Total publicity expense...............	
Other general selling expense.......	
Total	
Delivery	
Salaries	
Supplies	
Other delivery expense............	
Total	
Selling salaries	
All other selling expense.............	
Total selling expense.................	
All salaries	
All other expense.....................	
Grand total—all expense.............	

Fig. 45—Expense Review.

mand, style, and materials. It is the function of resident buyers to locate and develop new resources, to keep a current resource file, to place special orders and re-orders when the store's buyers are not able to come to the market; to follow and check up deliveries on merchandise which has been ordered; to arrange appointments with salesmen; to provide sample rooms; and to keep a record of terms so that each member of the association gets the best terms which are offered to any of the stores.

In order to take advantage of quantity prices, associations sometimes combine the individual orders or organize a special corporation for buying from producers who sell only to the jobbing trade. An office maintained by a group of associated stores permits market representation for medium- and smaller-sized stores that could not economically maintain their own resident-buying offices. Furthermore, it gives the smaller store an opportunity to compete with larger stores in obtaining favorable terms and services from manufacturers. The expense of maintaining a central office is usually distributed to the member stores on the basis of net sales. In one association which maintains a research and statistical department and makes periodical reports, each of the members is charged $300 per month and the remainder of the expense of the central office is distributed to each store on the basis of net sales.

Research bureaus.—In addition to the foregoing media of interchanging data, several independent research bureaus make periodic detailed studies of expenses in different types of retail stores. Chief among these is the Harvard Bureau of Business Research, which collects and analyzes yearly the expenses and net profits of several classes of stores. The high, low and common-expense percentages by divisions are made available to the different stores, so there is established certain standards of expense ratios by which the individual stores may measure their relative efficiency. The work of independent bureaus is essentially unbiased, and the data are usually given a skilled statistical treatment. One of the major benefits resulting from the work of research bureaus is the adoption by retail stores of uniform methods of procedure, particularly in accounting methods. The tendency at the present time is for the different research bureaus to co-

DEPT. NO.			
Week Ending	This Year	Last Year	Per Cent Increase Decrease
Purchases (bills passed) O. K.			
Purchases (inventory) (Jan. 1, incl.) to date			
Sales week			
Sales to date			
Reductions week			
Reductions to date			
Mark Up, per cent week			
Mark Up, per cent to date			
Stock			
Bills not passed			
Total Stock			
Orders Outstanding			
Advertising, per cent week			
Advertising, per cent to date			
Wages, per cent week			
Wages, per cent to date			
Discount, per cent to first of month			

Fig. 46—Report to Buyers.

ordinate their work so as to prevent duplication and to make available to the trade in general the studies of each bureau.

Internal statistics.—In order properly to merchandise a store or department, it is necessary to make frequent com-

DEPT. MANAGER WILL PLEASE SIGN AND DELIVER THIS SHEET ON MONDAY MORNING TO THE OFFICER OF THE CORPORATION TO WHOM HE REPORTS, AND MAKE ANY NECESSARY EXPLANATION.

________________ WEEK

	THIS YEAR	LAST YEAR
SALES		
STOCK AT COST		
MDSE. CHARGED THIS WEEK		
MARK ON THIS WEEK		
% TO DATE		
REDUCTIONS THIS WEEK		
% TO DATE TO SALES		
CASH DISCOUNT EARNED THIS WEEK		
% TO DATE TO PURCHASES		
SALARIES THIS WEEK		
% TO DATE TO SALES		
SALESCLERKS THIS WEEK		
TRANSACTIONS THIS WEEK		
NEWSPAPER ADV. THIS WEEK		
% TO DATE TO SALES		
REFUNDS THIS WEEK		
% TO DATE TO SALES		
AVERAGE SALES-CHECK THIS WEEK		
AVERAGE SALESCHECK TO DATE		
MDSE. RECEIVED CURRENT WEEK		

____

DEPT. MANAGER

Fig. 47—Buyer's Weekly Report.

parison between actual performance and past or planned performance. In the larger stores daily, weekly, and monthly reports are prepared by the controller's office and given to the executives who are responsible for the efficient operation of the different departments. The nature of these reports varies widely in different stores in regard to content and the

time which they cover. As a general rule, an executive should receive currently only the data which will afford a barometer of conditions over which he has control. Figure 46 is an example of information which the buyer of a large store is given weekly. This report shows the relation between the figures for the current year and the corresponding period of the previous year for purchases, sales, reductions, mark-up, stock on hand, bills not passed, outstanding orders, advertising, wages, and discounts. This form is made out in duplicate. A copy is filed in the merchandise office and the other copy kept by the buyer. Figure 47 shows the information which is given weekly to the buyers in a large store in New York.

The figures shown on this form are of direct current importance to a buyer as a guide in the proper operation of his department. By making a comparison of the present week with the corresponding period of last year and with the period to date, it is possible to gauge the tendencies in time to take preventive steps. The items shown on Figure 47 are for the most part within the control of the buyer. A comparison of sales and stocks indicates the rate of stock turn. The percentage of reductions to date indicates to the buyer and to the merchandise manager the approximate amount of maintained mark-up. It further shows whether the sales volume is being forced by excessive reductions. The average sales check is an index of the type of merchandise sold. This item is directly affected by a general change in price levels, in wage rates, or by a general tendency on the part of customers to buy in the lower-price lines of the department. As a guide in future purchasing it is important that the buyer watch carefully the trend of the average sales check. There is a normal seasonal variation in the size of the average transaction due to the nature of merchandise purchased at different periods of the year, so that dependable comparisons can be made only between corresponding periods.

The direct expenses, such as advertising, and salaries, are to a large degree subject to the control of the department manager, and for this reason they should be made a part of the weekly report. The percentage of refunds to customers has especial significance as an index of the comparative quality of the merchandise being sold. This item should be a guide

as to the need of merchandise training on the part of the salespeople. It should also be used as a guide in reordering from manufacturers.

In some stores a daily report is given to the buyer showing a résumé of the conditions of his department to date. Figure 48 is an example of the data which are given to buyers in one store. This report shows the condition of stock, orders, percentage of mark-down and mark-up, sales, and average sales. In the first column the amount of merchandise planned for the end of the month is shown. This amount is based on an experience sheet covering a period of ten years. The next three columns show the amount of merchandise on hand, in storage, and in transit, as evidenced by the invoices received. The next column shows the merchandise on order and the future orders as compared with the previous years. The percentage of mark-up is based on the purchase mark-up at the

BUYERS DAILY REPORT DAY________ MONTH________ 19____

RETAIL STOCK					ON ORDER				Net Mark Down	% MARK UP 1923				Dept's	SALES					AVERAGE SALE			
Estimated to be E.O.M.	In Stock	In Storage	In Transit	Total Stock	PRESENT		FUTURE			% Pur	% O M	% P R	Prom. % G M		TO DAYS		Estimated for Month	From 1st month to date		Feb. 1st to E.O.L.M.		Year Ending Jan. 31	
1923	1923	1922	1923	1922	1923	1922	1923	1922							1923	1922	1923	1923	1922	1923	1922	1923	1922
														16									
														18									
														46									
														59									
														61									

Fig. 48—Buyer's Daily Report.

first of the season. The next three columns show the percentage of gross margin at the first of the season, the percentage promised, and the percentage required. This is used as a guide to the buyers to get the necessary mark-up at the end of the period. The next column shows today's sales; that, of course, is for the day before, in comparison with last year. Next are the estimated sales for the month. The sales accumulated from the first day of the month are also shown so that the buyer has the amount from the first of the fiscal year to the date in question, as compared with the average sales of the month before.

In addition to the daily and weekly information shown in Figures 46, 47, and 48, some stores give the buyers a weekly or monthly report, showing the net profit or loss which their departments have made. Figure 49 is an example of a form used by one store to inform the buyer each month regarding the expenses and earnings of his department. With the information shown in this form a buyer may check his opera-

tion currently against the figures of the corresponding period of previous years and against the planned figures of the current year.

It is of special importance that the head of a department be given only those data which will aid him in the operation of his department. The number of current items which are necessary will vary with the size of the store and the nature of the merchandise handled. It is well recognized that the presentation of superfluous statistics results in a general lack

	Departments	Month		Period			
		192	Per cent	192	Per cent	192	Per cent
MERCHANDISE	Stock on hand beginning						
	Purchases						
	Mark on						
	Sales at Retail						
	Regular Reductions						
	Discount						
	Cost and labor reductions						
	Stock on hand end of month at cost						
	Stock on hand end of month at retail						
	Average (black) shortage (red) per inventory						
	(1) Merchandise profit						
EXPENSES	Administrative and general						
	Occupancy						
	Publicity						
	Buying						
	Selling						
	(2) Total expenses						
EARNINGS	Net merchandising profit (1) minus (2) equals						
	Cash discount						
	Net bill discount						
	Total profit						
INFORMATION	Outstanding orders						
	Number of sales						
	Average of sales						
	Turnover						
	Last inventory date						
	Previous inventory date						
	Third inventory date						

Fig. 49—Monthly Operating Statement.

of analysis of vital items by department managers. For this reason the compilation and presentation of all internal merchandising statistics should be made from the point of view of the one who is going to use the data.

Merchandising Policy as Affected by the Business Cycle.

The merchandising policy of a retail store must be adjusted to meet the changing conditions brought about by the more or less periodic rise and fall in the general level of retail and wholesale prices, which is one of the characteristics of the business cycle. Although retailers as a group are in no position entirely to prevent these cyclical price changes, they may avoid serious losses to themselves and also assist in decreasing the severity of price fluctuation by a general regard

and understanding of the cause of the business cycle and the indices of these changes. Although there are not available sufficient data to determine, for each commodity, the time when the top in prices has been reached, or when the process of liquidation and of falling prices is complete, there are certain characteristics of features of modern business, which forecast, with a reasonable degree of accuracy, the rise and fall in the general price level.

Phases of the business cycle.—Starting with a period of depression, the usual course of a business cycle may be summarized roughly as follows: The common characteristics of the first part of a period of depression are: A general decline in commodity prices, resulting in a waiting attitude on the part of retailers and consumers; a large amount of unemployment and a general falling in wage rates, thus decreasing purchasing power; low interest rates, because of increasing bank reserves and the lack of demand for money; low prices of securities and volume of speculation; industry typically running at low percentage of capacity and increasing business failures; the level of prices of raw material falling lower than the prices of finished goods, and wholesale prices declining more than retail prices.

When money rates reach a certain low point it is more profitable to purchase securities selling at a very low price, and idle funds are therefore drawn into the speculative market to purchase bonds and high-grade stocks. Funds at low rates are available to finance business and, consequently, business activity follows the advance in speculative activity. When the consumers feel that prices have reached the bottom they begin to purchase, and the retailer in turn places larger orders with wholesalers and manufacturers. Increased demand for commodities and money results in an upward trend in stock-exchange prices, followed by rising commodity prices, which is characteristic of the second phase of the business cycle, commonly called the period of revival.

Since stocks of goods have been reduced by the minimum buying during a period of depression, the initial demands of the consumer are reflected immediately in the orders of retailers, wholesalers, and producers. As new demand increases, more men are employed, and, although wage rates usually lag behind the rise in commodity prices, family income

is enlarged because of a larger number on the payroll. Thus, increased purchasing power and increased production are retroactive and cumulative in their effect. General business expansion and increasing demand for money and credit by both business men and speculators result in a flow of liquid assets into fixed capital, such as new plants and plant extensions, which is characteristic of the third phase, or the period of business prosperity. As the demand for money increases money rates are stiffened, and credit is strained. This is accompanied by a general curtailment of credit for speculative purposes. Business activity persists during this period of money strain, absorbing the available funds and decreasing the bank reserves.

During the initial stages of increased production there is a general decrease in unit costs, as unused capacity is utilized. As production increases, however, costs creep up on prices, due to increased money rates, less efficient labor, and increasing wage rates. As the demand for labor increases, the less efficient are pressed into service and old plants and equipment are utilized, resulting in a general decrease in production efficiency. Raw material prices, on the average, rise faster than the prices of finished goods, and wholesale prices faster than retail prices, thus contributing to narrower profit margins. The family income increases rapidly, as unemployment decreases, but, after the slack is taken out of the labor market, increases in family income are dependent solely upon increased wage rates, which usually lag behind the rise in the cost of living. Thus, the increase in consumers' demand begins to slacken. This in part explains why retail prices do not rise as high nor fall as low as wholesale and raw material prices.

During the period of rising commodity prices a large fictitious demand is produced by the practice of "over-ordering." The calls of customers are duplicated in several stores. In some cases one customer will ask for the same article in four or five stores, each of which registers a call. Similarly, retailers, wholesalers, and manufacturers, confronted with a scarcity of goods and increasing prices, duplicate their orders and place larger individual orders than are needed, so that, if their orders are cut down, they may still get an adequate supply. This practice leads to the purchase of inventory far

beyond the requirement to supply normal demands and to a consequent overexpansion of plant and equipment.

When prices reach a certain high level, there is a tendency among customers to curtail their purchases. In cases where the rise in prices is very great consumers frequently revolt and "buyers' strikes" occur. This condition was evidenced in the early part of 1920, when prominent public officials boasted that they had not bought clothing or shoes for some years and would not buy until prices were reduced. With the first indication of a slack in demand, orders and production are curtailed and a certain uneasiness ensues in different commodities. Activity in construction industries slackens. Construction costs, along with costs in general, have been greatly increased and plans for larger factories and new equipment are laid aside because of the difficulty in securing adequate capital. This results in an increase in unemployment. With the first indication of a slack in demand, banks begin to curtail their loans and to build up their reserves by calling in money from the more unstable industries. Money uncertainty and a curtailment of orders in certain industries are characteristics of the period just preceding a general business crisis.

There are usually some industries that expand more rapidly than others, and it is this irregularity of expansion which causes weak places in general business, and as a consequence banks call in old loans or refuse new ones, thus precipitating a general business crisis. The checking up of old loans and the refusal to make new ones are cumulative in their effect at a time when the solvency of most businesses is dependent upon their ability to get money or credit. In order to get working capital, industry in general must liquidate its inventories. This usually results in drastic mark-downs and a general cancellation of the orders which were placed because of a fictitious demand. Decreased orders result in decreased production, increased unemployment, and consequent decrease in purchasing power. Thus liquidation becomes as cumulative and retroactive as prosperity. Following the crisis, there are cancellations of orders, closing of factories, unemployment, rapidly decreasing rates for loans, and increasing bank reserves, resulting again in a period of business depression.

Cancellation of orders.—A break in the general level of commodity prices is usually accompanied by a widespread cancellation of orders by retail stores, as a method of avoiding the accumulation of excess inventories. The amount of these cancellations varies with the severity of price changes and the type of merchandise. In seasonal style goods, such as shoes and hosiery, the cancellations in 1920 were extremely heavy. As already pointed out, excessive cancellation of orders is usually the result of the duplication of orders on the part of retailers. When a break in prices comes the problem of cancellation ordinarily is one of merchandising policy rather than a legal matter, inasmuch as the retailer can usually find a legitimate excuse to refuse orders which are placed immediately preceding a general break in prices. Delinquency in delivery is particularly likely to occur in a period just preceding a business crisis, because of the inability of the manufacturer to get raw material and labor to produce the commodities at a particular date. Transportation delays also are likely to occur at the peak of the boom that precedes a crisis, so that deliveries are slow. Another difficulty in the enforcement of legal liability of retailers who cancel orders is found in the poor workmanship and imperfections in material which naturally result from forced production. That they may fill orders the manufacturers are prone to pass over imperfections in material and workmanship which materially interfere with the legal enforcement of acceptance of deliveries by retailers after a drop in prices begins. During the "sellers' market" which precedes a business crisis there is a general tendency toward substitution. When the seller attempts to force acceptance of the goods it usually is possible for the retailer to point out enough imperfections in the fabric and workmanship to serve as a legal excuse for being relieved of all liability on the order.

The possibility of forcing retailers into bankruptcy by enforcement of the acceptance of delivery sometimes deters action on the part of sellers, because manufacturers or wholesalers find that the loss suffered by reason of cancellation frequently is less than the loss that would result if the retailer were thrown into bankruptcy. Another factor to be considered is the future business or the goodwill of the retailer. A manufacturer, as a matter of policy, cannot afford

to force acceptance upon larger stores, because of their future business, and generally it is not economical to force acceptance of orders by smaller stores.

A good merchandising policy requires a direct flow of goods from producer to consumer, without any back flow or accumulation of stock. To maintain this flow of goods, it is necessary that there be coöperation between the manufacturer, wholesaler, and retailer during all stages of the business cycle. In 1920, when the general retail price level started downward, many retailers had large stocks on hand and large outstanding orders. The same condition was found in 1907 and in 1914. The experiences of these retailers have naturally made them overcautious during the period immediately following a business crisis, with the result that they follow an extreme policy of hand-to-mouth buying at a period when the manufacturing industries need orders to start operations. This policy is pursued during the period of depression and the first part of the period of revival, because of lack of capital and of the losses which were recently incurred as a result of their overstocked condition.

As prices begin to show a definite trend upward, the retailer increases his percentage of outstanding orders in staple lines. He takes the appreciation in merchandise on the upward grade, and in time his working capital is back to normal and his confidence is restored. At this stage of the business cycle most retailers fail to adjust their merchandising policy to future conditions which history has definitely shown will occur. Instead of increasing the percentage of outstanding orders he should start to decrease them so that, when near the top of the price level, he is again buying from hand-to-mouth. When prices are going up he should price his merchandise on a replacement basis, to build up a liquid financial reserve to take care of the mark-downs in a falling market. During the rising prices of 1918 and 1919 there were several court actions brought against retailers to force them to place mark-ups on cost rather than on replacement cost. Those insisting on the procedure failed to consider that on a falling market competition forces the retailer to price merchandise in replacement costs and that, unless he has built up a cash reserve on a rising market, he will necessarily suffer a net loss during both the rise and the fall of the general price level.

In actual practice a great many retailers fail to decrease their orders when nearing the peak of a boom period. This is due to three very definite reasons: (1) their inability to tell when prices are going to break; (2) their desire to insure ample stock to take care of their demand before prices go higher; and (3) their failure to realize the losses which may occur, because of the lapse of several years since their former experience. It was apparent during the latter part of 1919 that the peak of a boom period was at hand. The general symptoms were typical of those that had preceded other crises. In the fall of 1919 orders were being taken for the spring season at price increases of from 20 to 40 per cent. It was evident that the normal consumer demand would be curtailed by such a radical jump in prices. There was a tendency for money rates to begin to tighten as early as November, 1919. In many cases retailers and wholesalers were placing forward orders for their entire spring requirement, instead of the normal orders of 35 to 50 per cent, and, in addition, there were numerous instances in which orders were duplicated with several manufacturers. There were also, at this period, symptoms of labor unrest, transportation difficulties, and hysterical markets. These were the common indices of previous changes in general business conditions.

Conclusions.—Inasmuch as there are available insufficient data to determine for each commodity the time when the top in prices has been reached, or, when the process of liquidation and of falling prices is complete, it is impossible for individual retailers to make an accurate adjustment of their buying policies. Through the coöperation of wholesalers and manufacturers the condition of the trade in general may be more accurately determined. If, during the months that precede a crisis, a substantial number of manufacturers and wholesalers would acquaint their salesmen with the real condition and instruct them to desist from advising retailers to buy in anticipation of further price advances, the severity of the depression would be greatly alleviated. It is to the advantage of both manufacturer and retailer that large orders at the top of the upward price movement should not be placed. A manufacturer who is selling to a large number of retailers is in a position to draw conclusions as to general business conditions. There is everything to gain and little to lose on the

part of a manufacturer by a conservative sales policy in the months preceding a crisis. By paying salesmen a salary rather than a commission, and by advising them not to accept orders out of proportion to the requirements of the individual retailer, there would be a tendency to inspire a spirit of caution at just the time when overexpansion is taking place at the most rapid rate.

There is available at the present time a mass of statistical information on raw materials and conditions in different industries. Rapid progress has also been made in forecasting general business conditions and in determining the relation between prices of individual commodities and the general business curve. Some of the larger retail organizations, notably R. H. Macy & Co., of New York, and Wm. Filene's Sons Company, of Boston, are operating statistical departments, the function of which is to study the general business conditions and the conditions in individual industries. Wages, stocks on hand, productions of raw materials, labor conditions, and the probable tendencies in prices are recorded to give a basis for better judgment in buying merchandise.

There is reason to believe that, as this type of study and analysis becomes more general, it will have a tendency to curtail the overexpansion of business and to lessen the severity of general business fluctuations. The interchange of information regarding the condition of stocks and sales in retail stores will help to reveal the facts which will show that oftentimes a supposed shortage is fictitious, thus preventing an abnormal duplication of orders. At other times it will show that the surplus stocks on hand are not excessive, which will prevent an abnormal curtailment of purchases which tends to intensify depression from wholesalers and manufacturers.

During the last few years the retail stores have been severely criticized, because of the wide margin which exists between the manufacturer's price and the price to the consumer. In some instances this criticism has resulted in investigations by the government of the retailer's mark-up. Through these government investigators, the research activities of retail trade associations, and the studies of the research bureaus of different universities, it has been well established that, although the retail stores do show a wide gross

margin, their percentage of profit is relatively small in comparison with industry in general. Although there are certain elements of waste and inefficiency for which the retailer may be held responsible, the high cost of distribution to a large measure is the result of the large number of services which the retail store performs for the consumer. The major portion of the criticism has resulted because of the failure on the part of the general public to consider the cost of service in the same light as the cost of merchandise.

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Problems.

1. Twelve non-competing department stores, located in the Middle West, have recently formed an association for the purpose of interchanging trade information and current statistics, and of doing group buying. The sales of these stores range from $1,500,000 to $7,000,000. The officers of this association are anxious to interchange all merchandise and expense statistics which will be truly comparable and which will aid the member stores. The controller of one of the member stores has been asked to submit a list of the items which should be compared weekly, monthly, and annually.

(*a*) What statistics should be interchanged for each of these periods?

(*b*) What steps should the controller take in order to insure that these data are truly comparable?

(*c*) What particular advantage may a member store expect to gain from an interchange of these statistics?

2. The following data represent, in part, the sales statistics for three stores reporting to the Federal Reserve Board:

SALES STATISTICS OF CERTAIN DEPARTMENTS OF THREE STORES

	November 1924	October 1924
Store 1		
Men's and boys' wear	$ 14,000	$ 16,000
Furniture	18,000	22,000
Women's ready-to-wear	38,000	42,000
Store 2		
Men's and boys' wear	24,000	22,000
Furniture	32,000	36,000
Women's ready-to-wear	58,000	63,000
Store 3		
Men's and boys' wear	72,000	72,000
Furniture	92,000	94,000
Women's ready-to-wear	210,000	218,000

Assuming that these departments represent the entire sales of each store, and that these three stores are the only ones reporting from the Federal Reserve district, make out a sales barometer for the month of November for the district as a whole, for each store, and for each of the three departments within each store.

3. The Alton & Stone department store, of Brooklyn, has a very detailed method of merchandise control. This store has an annual sales volume of approximately $30,000,000. About the middle of 1924 a system was introduced for checking up currently on the weaknesses of the different departments. The statistical department prepares a monthly report showing the actual condition of each department as to stock, sales, mark-up, expense, number of salespeople, etc. This report is sent to the merchandise manager's office and from it the "hospital sheet" is made out.

The hospital sheet is a tabulation of figures showing the conditions which are not as they should be. For example, if the stock is too high the actual figures for the department are copied on the hospital sheet in red and the figures as they should be are copied in black. When a department is first placed on the hospital sheet the figures are underlined in red and when they leave the sheet they are underscored in green. Each divisional manager receives a sheet covering the departments under his supervision.

The merchandise manager of the Alton & Stone store feels that by this system a current check is made on the weaknesses of the different departments. He is not certain, however, that he is sufficiently familiar with the condition of the different departments to be able to point out their weaknesses. He is considering having the hospital sheet made out in duplicate by the divisional merchandise managers; one copy going to the merchandise manager and the other to the buyer.

Should the proposed plan be adopted?

4. The first National Distribution Conference was held in Washington, D. C., on January 14 and 15, 1925. Under the program as worked out for future effort, committees of business men will study six major elements of distribution and will prepare formal reports covering their investigations. These six major subjects have to do with the collection of statistics on distribution, trade relations, market analysis in relation to advertising and advertising mediums, expenses of doing business, methods of distribution, and general conditions affecting distribution.

One of the problems of the committee on the collection of statistics on distribution will be to provide a plan whereby periodical comparisons may be made between (1) quantities of commodities produced and on hand, and (2) prices of the commodities at wholesale and retail to give distributors a knowledge of market conditions in order that intelligent buying and selling policies may be adopted and extreme market fluctuations avoided.

A second problem of this committee will be to provide a plan for taking a census of distributors substantially like the census of manufacturers now conducted by the department of commerce (1) in order to judge the relative need for more or less establishments in various localities; (2) for the elimination of wasteful marketing efforts; and (3) for the estimation of accurate sales quotas.

(*a*) What figures should this committee recommend for collecting periodically to show the quantity of commodities produced and on hand in retail institutions?

(*b*) Outline a plan for the collection of retail and wholesale prices.

(*c*) Would a census of distributors give the benefits suggested by the committee?

INDEX

INDEX